

The Canadian Chartered Accountant

OFFICIAL ORGAN OF

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

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The Editorial Committee will be pleased to receive contributions on subjects of interest. Papers which may not be deemed suitable will be returned, if desired.

AUSTIN H. CARR, Editor,
10 Adelaide Street East, Toronto

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ISSUE No. 182

(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association).

Editorial Comment

The Annual Meeting

As this issue was going to press the annual meeting of our Association was opening its sessions in Halifax. A full report of the meeting and some of the addresses given will appear in next month's issue.

Educating Accountants

The Institute of Chartered Accountants in England and Wales until recently assumed no responsibility for the professional education of articled clerks but confined itself strictly to the functions of regulating service under articles and of examining those who presented themselves for examination.

Two years ago the Institute, being convinced that it must concern itself with education, instituted as an experiment a system of tuition towards the cost of which it has made a grant of £3,500 for each of the past two years. The original plan of instruction has been modified somewhat as a result of experience gained in the initial period and is now confined almost exclusively to the provision of lectures in various parts of the country, the lectures being given by the staffs of professional coaching establishments. In his recent presidential address to the Institute, Mr. Lindsay Fisher, C.B.E., admitted that a weakness of the scheme lay

in the absence of any discipline and the consequent failure of many students to take advantage of the lectures offered. He urged that the formal lectures provided by the Institute should be supplemented by more intimate tutorial classes organized by the regional societies and taught by young chartered accountants and lawyers. Finally he expressed the personal opinion that the ideal system was a combination of oral classes and correspondence courses. This is a view which is apparently shared by some of the Canadian Institutes and Students' Associations who while subscribing to correspondence courses are organizing study groups conducted by recently qualified chartered accountants. Complacency is a deplorable thing, but we think that the profession in Canada looking back over the past twenty years can quite properly derive substantial satisfaction from the success to date of its own vigorous pioneering in the field of accounting education.

While good progress has been made in recent years, the profession in Canada is giving considerable thought to the demands which will be made upon members in the future. At the annual meeting of the Dominion Association held in Vancouver a year ago a thought-provoking paper was presented on the subject "Educating our Students—What is our responsibility?" which was published in our October issue. Since then a committee of the Association has been devoting some study to the possible standardization of accounting education of the nine provincial Institutes and uniform examinations, and will be making a report to this year's annual meeting.

*The Dominion
Low Rental
Housing Plan*

The "Act to Assist the Construction of Houses" which was passed in the closing days of the last session of parliament implements the recommendations of the National Employment Commission by "liberalizing" the provisions of the Housing Act, 1935, and by providing financial assistance for the construction of low rental houses. Parts I and III of the Act by providing for loans up to 90% of the lending value of houses up to \$2,500 and for the assumption by the Dominion government of a substantial part of the municipal taxes for three years on houses up to \$4,000 should prove a stimulant to small

home construction and be of real benefit to the building trades.

The most interesting part of the Act however is Part II which constitutes an experiment in low rental housing and which is designed as much to improve living conditions of the poorer people as to assist the construction industry. Dominion loans are to be made available at low interest rates to either local authorities or limited-dividend housing corporations and are to be amortized by equal half yearly payments over a period of approximately thirty-five years. A local authority is required to have an equity of ten per cent. and a housing corporation an equity of twenty per cent. in any scheme undertaken, and numerous conditions are attached to the loans including an undertaking by the municipality in which the houses are to be built "that taxes of all kinds levied by the municipality . . . shall not exceed in the aggregate one per centum of the cost of construction of the houses." This condition constitutes the principal contribution exacted from municipalities towards the housing problem and as a departure from the recommendation of the Employment Commission it is, in our opinion, distinctly inferior. The recommendation of the Commission was for all the provinces and the municipalities to contribute jointly up to \$1.25 per month per adult-accommodation towards a fund which would be applied to reduction of economic rents in accordance with the ability of families to pay. The Act, instead of accommodating the rentals to the means of the applicants for rental, effects a flat reduction in all rentals and so makes it inevitable that all the houses will be rented to families with the largest permitted income (which is approximately ten times the rental) and creates a special assessment in favour of a class which is not in need of municipal assistance. The relief to the very poor will come indirectly as houses at present occupied by workers with the "maximum permitted income" are vacated and the rents of these houses are brought down by the supply of new houses.

It will take time for the attitude of the municipalities and the provinces to take shape and no matter how favourable this attitude may be it is unlikely that any use can be made of Part II of the Act until next year in those jurisdictions in which the provincial legislative assemblies

will be required to legislate power to municipalities to accept the conditions imposed on them by the Act.

The Civil Servant of the Future Whether we like it or not it seems certain that even in those countries which reject the formal "planned" economy the state's interest in and control of the citizen's affairs will continually expand. In Canada as in the other surviving democracies the day is long past when the sole function of the state was to maintain internal order and security from external attack. It is now regarded as proper and indeed essential that the state should assume many of the responsibilities that were once shouldered or shirked by the individual and that there should be communal engagement in a great variety of undertakings. The rate of movement in this direction is likely to quicken rather than diminish, and increasingly legislative enactments will be analagous to decisions of boards of directors in that they will do no more than indicate lines of policy to be worked out and put into effect by a managing director and his staff of executives. The traditional civil service is not, however, in either temperament or training the counterpart of a managing director and his staff, but is a group of men and women capable of giving precise effect to detailed rules formulated by the legislature. Up to the present time we have contrived to get along without giving much thought to this problem of adapting our civil services to the changing need, but every succeeding day emphasizes the urgency of that problem. What the new type of civil servant should be and what form of training he should receive are questions which will be answered only after careful and patient study. The experience of the United States derived from administration of the New Deal legislation does not afford much help beyond indicating that neither the legislative nor the purely academic type of mind and training will produce the ideal type of administrator for the modern state.

Accountants and Tax Evasion

The ancient dictum that a taxpayer can quite lawfully arrange his affairs so as to attract a minimum of taxation is doubtless a perpetual thorn in the flesh of revenue authorities. It not only results in revenues lower than were anticipated but it also involves a continual

battle of wits in which the authorities, through no inherent fault of their own, are always on the defensive. It would obviously be a much happier world for them if the taxpayer instead of being allowed to explore a fiscal statute for loopholes were required to ask himself whether, if the legislature had foreseen the loopholes, it would have left them open. This merely amounts to saying that revenue authorities could collect more taxes if they were allowed to assess them according to what, in the light of subsequent experience, the legislators should have had in mind but did not have at the time they imposed the tax. Such an attitude seems to us to be unsound both morally and legally, and its adoption to involve an authoritarianism repugnant to the senses of democratic peoples.

The interest of the accountant in this matter arises out of the consideration whether it is ethical for him to be a party to legal evasion of taxes. The question was raised in acute form in Great Britain earlier this year by the words used by the Chancellor of the Exchequer in his budget speech and by subsequent comment in the British press, and it was considered of sufficient importance to warrant an extended reference in the Presidential address to the annual meeting of the English Institute last May. Mr. Fisher explained that he was dealing with the question whether the chartered accountant ought to tell his client that he could not aid him in any legal avoidance of tax, or whether he was justified in giving assistance if there was nothing underhand or illegal contemplated, and then went on to say: "Speaking for myself alone, I feel that however much we may disapprove of a client's avoiding taxes in a legal manner a member is doing nothing morally reprehensible in giving his client the benefit of expert knowledge . . . Just as a judge frequently states that it is not his business to make laws, but to administer them, so, I would argue, it is a chartered accountant's duty to see that the provisions of the Finance Acts are observed, and to assist his client, when called upon, to contribute to the National Exchequer only the minimum sum required by such Finance Acts." With this restrained statement we believe most of our readers will be in complete agreement.

In 1932 Mr. S. H. Frankel published in *The Return on Common Stocks* *The Economic Journal* a paper on "The Return to Capital Invested in the Witwatersrand Gold-Mining Industry." The method adopted was to suppose that an investor on 1st January 1901 bought all the common stock of the companies studied, that he subsequently supplied all the new common share capital that was introduced, and that he sold out his interest at the market price on 31st December 1936; and thereby to compute the average annual percentage return that this imaginary investor would have got on his money.

A corresponding unpublished study was recently made by Mr. W. H. Tupling of the return on common stocks of Canadian companies from 1901 to 1936 and its conclusions are of considerable interest. The study was based on twenty-five companies selected as having had a continuous existence over the period in question and is therefore biased in the sense that the companies comprising the sample do not include any company which was forced into liquidation prior to 1936. The results are therefore more favourable presumably than would be the results for all companies doing business in Canada within the period. They show average annual returns from 13.51 per cent. in the case of the most successful company to -8.78 per cent. in the case of the least successful one, or a range of 22.29 per cent., while the unweighted arithmetic average for all twenty-five companies is 3.83 per cent. The typical weighted yield for the whole sample was between 5.00 and 5.25 per cent., a figure which can usefully be compared with the average yield on Province of Ontario bonds for the same period which was 4.55 per cent. It would seem that the return for risk bearing is not high, particularly when it is remembered that the study made no allowance for changes in the value of money, and that these changes between 1901 and 1936 would operate to the advantage of the common stockholder.

The Dominion Association of Chartered Accountants

A FORMER PRESIDENT PASSES ON



THE LATE FRANK M. HARVEY, F.C.A.
President of the Association 1932-33

Members of the profession will read with very deep regret in the obituary column this month of the death at Calgary on 3rd August of Frank Micklewright Harvey, a former President of our Association. Mr. Harvey was a distinguished member of the profession and was regarded throughout Western Canada as an authority on the accounts of municipalities and public utilities. It will be recalled that the address which he delivered at the annual meeting at Saint John in 1932 was entitled "The Accountancy of Rate Making."

As one devoted to the development of the profession of the chartered accountant, Mr. Harvey gave unsparingly of his time to the work of the Dominion Association and of the Alberta Institute during the past twenty years. "We do not live unto ourselves alone," he stated in his Presidential address at the annual meeting of the Dominion Association in 1933, "and what we do in our daily round of duty carries an influence far and wide. May that influence be such that when we sit alone with our thoughts, we can honestly feel that our contribution has given something material to the common good."

His was a lovable personality; these closing words of his address in very truth sum up the credo of his life.

—The Editor.

Supplement to September issue The Canadian Chartered Accountant



A PROVINCIAL SALES TAX

by E. C. Shaughnessy, Chartered Accountant,
Edmonton, Alberta

THE main purpose of this article is to outline the system of accounting for revenue derived from a provincial sales tax. It may be of interest to readers, however, to know of the productivity of this type of tax and the extent which it has been resorted to in recent years by provincial and municipal governments in Canada and state governments in the United States.

At the end of 1932 eight states of the American Union had sales tax laws, while such laws were unknown in Canada at that time. At 1st July 1937, however, twenty-seven states and one municipality in the United States, and two provinces and one municipality in Canada were imposing sales taxes. The sales tax laws in Canada, as enacted by the governments of the provinces of Alberta and Saskatchewan and by the city of Montreal, impose the tax on the purchaser of commodities at retail. The sales tax laws of the states have a much wider base in many instances; in fact, in some cases the name "sales tax" would not appear to be entirely appropriate. The Tax Commission of Ohio prepared an analysis of state sales taxes as of 1st February 1936 showing the base to which the tax applied in the twenty-six states having sales tax laws at that time. In this analysis the laws of the various states are set out under five classifications in accordance with the nature or width of the base of the tax imposed. These classifications are briefly defined hereunder, together with the number of states imposing such tax:

Retail sales tax—primarily applies to retail sales or gross receipts from retail sales	15 States
General sales tax—in addition to retail sales applies to items sold for resale by wholesalers	2 States
Gross receipts tax—includes also receipts from services and professional occupations	3 States

Gross income tax—includes receipts from practically all sources	2 States
Mercantile license or occupation tax—requires retailers and wholesalers to pay a license fee plus additional charge on a flat amount or graduated scale based on total volume of business	4 States
	—
	26
	—

The width of the base to which the tax applied in the various states, as at 1st February 1936, excluding the four imposing a mercantile license or occupation tax, is illustrated by the following:

BASE	Number of States in which tax applied
Retail sales—	
Tangible personal property	22
Utility services	17
Amusements	14
Communications	16
Advertising	8
Services—	
Publications including newspapers	10
Professional, including doctors, lawyers, etc.	5
Other services, including barbers and plumbers, etc.	5
Financial	3
Transportation	9
Natural resources—	
Coal, gas, oil, etc.	5
Timber	5
Minerals	5
Agriculture	4
Incomes—	
Investments	2
Rentals—Real estate	2
Salaries and wages	2

A PROVINCIAL SALES TAX

Object of Sales Tax

Sales taxes are highly productive. The ultimate purchasers tax,¹ as the tax is known in Alberta, with extensive exemptions is estimated to yield annually \$1,600,000, while Saskatchewan's education tax with but few exemptions is expected to produce an annual revenue of \$1,850,000. In 1935 in the United States the greater part of the population paid sales taxes totalling in excess of \$400,000,000. In the State of Ohio the yield in the past three years has been as follows:

1935	\$47,849,000
1936	58,552,000
1937 ²	53,077,000

The proceeds of sales taxes are devoted to various objects. In Alberta the revenues were placed in the general revenue fund; in Saskatchewan they are allocated to education, while in the State of Ohio they are, in the main, distributed back to local governments. In the year 1937 this state made the following distribution:

Schools	\$ 22,693,000
County, municipal and township govern- ments	15,129,000
Poor relief	5,555,000
Retirement of poor relief bonds	4,000,000
<hr/>	
Total distributed back to local govern- ments	\$ 47,377,000
Amount undistributed	445,000
<hr/>	
Total allocated to local governments ..	\$ 47,822,000
State general revenue fund and refunds ..	2,376,000
Discounts to vendors, etc.	2,879,000
<hr/>	
\$ 53,077,000	
<hr/>	

Administration

There can be no comparison of the administrative machinery required to operate a sales tax law in a state such as Ohio, where there are 325,000 registered vendors, with

¹Tax suspended 9th August 1937.

²Decrease in 1937 due to exemption from tax of foodstuffs.

that required in the province of Alberta where the registered vendors total only 15,000. However, regardless of where the law is operative, the main function of any system is to protect the revenue to the greatest extent possible. In the writer's opinion the maximum protection is afforded by the Ohio system of official prepaid tax receipts. Under this system the vendors purchase the receipts from the state treasurer and recoup their investment from the consumer. The problem of the administration is thus reduced to seeing that vendors collect the tax in all cases and that official receipts are given. Unfortunately, due to the prepayment feature, there is the element of indirect taxation in this system and therefore it may not be within the powers of the provinces and municipalities of Canada to collect the tax in this manner. However, official receipts could be issued on a consignment basis. Tokens, as used in many states in connection with sales taxes, form a medium of payment of the tax where payable in fractions of a cent, but do not provide protection for the revenues. In the province of Alberta the tax was collected from the purchaser by the merchants who were appointed registered vendors, and who in turn were required to make monthly returns of their collections. Thus, here, in addition to the problem of tax evasion by purchasers, there was the problem of delinquent vendors. The latter may be controlled internally by routine procedure, but evasion can be checked only by constant inspection of vendors' records as such offence is possible only by the collusion of vendor and purchaser.

The system of accounts installed for *The Ultimate Purchasers Tax Act* (Alberta), includes a general ledger and a subsidiary vendors' ledger. Posting machine abstracts replace books of original entry. Postings to the general ledger are made direct from the master controls of the vendors' ledger which are but a recapitulation of the posting machine abstracts.

The general ledger consists of the five following accounts:

Provincial Treasurer, General Revenue Account — In this account are recorded all cash collections which are deposited to the credit of the Provincial Treasurer.

Vendors' Commissions—To this account is charged the amount of vendors' commissions deducted by vendors prior to remitting tax collections.

Accounts Receivable—This is the control account for the corresponding division of the vendors' ledger, the transactions herein recorded arising out of special assessments against vendors for unremitted tax, etc.

Tax Revenue—To this account is credited the gross revenue, cash received plus vendors' commissions. This account also operates as a control for the cash and commission columns in the upper, or statistical division, of the vendors' ledger.

Special Assessments—To this account is credited the amount of special assessments made against vendors. A periodical adjustment is made for paid assessments, the amounts of such assessments being transferred to Tax Revenue Account. This adjustment is necessary for statistical purposes.

The vendors' ledger is divided into two parts, the statistical division and the accounts receivable division. In the statistical division are recorded the exempt and taxable sales, cash remitted by vendors and vendors' commissions as set forth on the monthly return forms. In the accounts receivable division are recorded all transactions in respect of special assessments against vendors for unremitted tax, etc. Exhibit "C" illustrates the vendors' ledger card. In the upper or statistical division a debit column for stamps issued and a balance column are provided in the event of it being desired to issue official receipts. Such receipts would be issued on a consignment basis, the vendor being charged with the amount they represented. Remittances and commissions would be credited to the vendor and any balance remaining would represent the "value" of receipts in the hands of the vendor.

Effective Records Necessary

Before dealing further with the system it is necessary to explain the order in which records are kept and documents filed. With the exception of investigation files which are maintained geographically by cities, towns and villages, and the duplicates of certain documents, all records are kept in trade classification order. Exhibit "B" lists the trade classifications and the corresponding code numbers.

All records and documents bear this code number and in addition the alphabetical index and registration number of the vendor. Exhibits "C" and "D" illustrate the complete coding. John Jones is a general merchant using the trade name of "Jones General Store." The first number of the coding, 31, represents the trade classification, the second number, 318, the alphabetical index and the third number, 2000, Jones' registration number. Under this system, to locate an account is a matter of seconds only. You first go to the proper trade classification division and then to the alphabetical division, which is plainly signalled and broken down into sufficient divisions to insure that only a few accounts appear in each division. An alphabetical master list of all vendors is maintained in order that the coding of any vendor may be obtained when required.

The routine from the receipt of the application for registration to the recording of vendors' remittances is as follows:

Application for Registration—After applications for registration are approved they are coded according to trade classifications, alphabetical indices and registration numbers.

Addressing Plates—When an application has been approved a metal addressing plate is made showing the vendor's name, trade name, address and code numbers. This plate is then used for all purposes, whether addressing mail, returns, or heading ledger cards, etc.

Vendors' Monthly Returns—The forms for the monthly return of sales and tax collections required to accompany vendors' remittances, prior to being supplied to the vendor, are pre-addressed by use of the addressing plate, with the vendor's name, address, code numbers, etc., and in addition the month for which the return is to be made is noted. These forms are in triplicate and of inter-leaved carbon construction, and the vendor is required to forward them to the Department intact. Exhibit "D" illustrates the monthly return form. It will be noticed that the form provides for a reconciliation of official tax receipts should it be desired to issue such receipts.

When received the returns are receipted by a cash register for the amount remitted, the cash register figures, by virtue of the inter-leaved carbon, appearing on all three

copies. The cash register also prints the receipt number. The original now becomes the vendor's receipt, the duplicate the posting medium to the vendors' ledger, and the triplicate the audit copy.

At the end of each day the chief accountant prepares a tape of the amounts remitted, the amounts being listed in receipt number order. The returns are checked for missing numbers and the beginning number checked with the closing number of the previous day. The amount shown by the chief accountant's tape is then agreed with the cash register tape and cashier's deposit. The chief accountant's tape then accompanies the duplicates to the posting clerk providing a predetermined total. The originals, or receipts, go to the mail room and the triplicates to the audit clerk.

Vendors' Ledger—The posting medium to the statistical division of the vendors' ledger is the duplicates of the vendors' returns. These duplicates, when received from the chief accountant, are sorted by trade classifications. In this order they are posted to the vendors' accounts. As the posting to each classification is completed, the totals of sales, cash, commissions, etc. accumulated by the posting machine are thrown on the classification control cards. At the end of each day's postings the totals of the various classification controls are recapitulated and thrown on group control cards and the group control totals in turn recapitulated and recorded on the master control. The total cash posted to the master control must agree with the cashier's deposit for the corresponding day.

The posting mediums to the special assessment or accounts receivable division are debit and credit memoranda originating in the department from inspectors' assessments, or for unremitted tax and over- and under-deducted commissions, etc. and duplicate copies of receipts issued at the time of payment of debit balances. Debit and credit memoranda are both posted to the debit column, the latter appearing in red, and receipts alone are posted to the credit column. This facilitates the balancing of cash items with the cashier's deposits. These receipts are listed separately from the regular returns by the chief accountant and a separate predetermined total established. The debit and credit memoranda are analyzed to determine the amount which arises through inspectors' assessments, thus furnishing information as to the value of inspections. The

accumulated totals of debit and credit postings are recorded daily on a master control.

At each month end the general ledger is posted from the vendors' ledger master controls. From the statistical division control the total cash is charged to the Provincial Treasurer—General Revenue Account and total commissions to Vendors' Commissions Account. The total of these two postings is credited to Tax Revenue Account. From the special assessment division control the net debits are charged to Accounts Receivable and credited to Special Assessments; the cash charged to Provincial Treasurer—General Revenue Account and credited to Accounts Receivable. Periodically adjustments are made where special assessments have been paid in full, clearing the cash from the lower to the upper division. At the same time an entry for the total of such adjustments is made debiting Special Assessments and crediting Tax Revenue Accounts. This adjustment is necessary for statistical purposes only.

The duplicates of returns are filed in trade classifications by months. The duplicates of debit and credit memoranda and receipts are filed in numerical order, all numbers being accounted for.

Audit Clerk—The triplicate copies of the monthly returns are forwarded from the chief accountant to the audit clerk, who checks the vendors' commission computations. Where errors appear this clerk has debit or credit memoranda prepared which he forwards to the posting clerk. When checked the triplicates are filed on the vendors' investigation files.

Special Features

There are certain special features of the system which are of interest and are briefly outlined hereunder:

(a) *Control of Delinquent Vendors*—Delinquent vendors are controlled by the simple expedient of furnishing them with a return form for the current month when the return for the previous month has been filed. As explained above, the original of returns when receipted become the vendors' receipts and are forwarded by the chief accountant to the mail room. There, awaiting the arrival of the receipts, are previously addressed envelopes and the current months return forms. The envelopes and forms are prepared for all vendors at one time and placed in a "cur-

rent" file in the order of their coding. As they are withdrawn from the file upon the arrival of the receipts, their number is reduced accordingly, and when the filing date has passed delinquent vendors are immediately ascertained, being represented by the envelopes remaining in the file. These envelopes are then removed from the "current" file and transferred to the collection clerk who takes immediate action to procure the current return due. The "current" file is now free to receive the envelopes and forms for the next succeeding month.

(b) *Statistics*—The posting machine, in addition to posting each vendor's account, automatically accumulates statistics. As each return is posted the machine accumulates separately the exempt sales, taxable sales, tax remitted and commission deducted. This information is transferred to a control card when the returns for each classification have been posted. At the end of the day the total of all classifications are recapitulated and transferred to a master control. Thus, at the end of each day statistics to date are available. Statistical statements for the fiscal year to date are prepared at each month end. These statements set forth for each trade group the total, exempt and taxable sales, gross revenue, vendors' commissions and net revenue. Percentages are also listed and where any group appears to be out of line each classification within that group is investigated in an effort to determine the cause.

(c) *Investigation Files* — Constant and competent inspection of vendors' records is essential to the successful operation of a sales tax law. In order that inspectors may be in possession of complete information a separate inspection file for each vendor is maintained. These files contain copies of all returns filed by the vendor, copies of any special assessments and the inspector's work papers. These files are kept in geographical order by cities, towns and villages, with the cities being zoned. At the time files are assigned to an inspector a routing sheet, in duplicate, is prepared. The original accompanies the files and the duplicate remains in the possession of the chief inspector, thus giving control over "out" files.

When an inspector completes an inspection he makes a covering report, prepares an assessment if required and returns the file to the chief inspector who reviews the work

papers and report, and confirms or amends the assessment, after which any necessary debit memorandum is issued.

To insure uniformity in inspection reports the work papers to be completed are furnished to inspectors in printed form.

Conclusion

The foregoing briefly outlines the system of accounting for revenue derived from a provincial sales tax and together with the flow chart, Exhibit "A", gives the reader a general view of the requirements.

In closing it should be mentioned that sales tax revenues in the hands of registered vendors are trust funds and must be accounted for accordingly.

EXHIBIT "B"

TRADE CLASSIFICATION OF VENDORS

<i>Code No.</i>	<i>Group</i>
	1. FOOD GROUP
11	Bakers, Butchers and Fish Merchants
12	Creameries and Dairies
13	Grocers, Confectioners, Fruiterers, Ice Cream Parlours, Apiaries
14	Hotels, Restaurants
	2. APPAREL GROUP
21	Furriers and Fur Dealers
22	Ladies' and Men's Furnishings, Tailors, Dressmakers, Milliners, Cleaners and Dyers
	3. GENERAL MERCHANDISE GROUP
31	Department and General Stores
	4. AUTOMOBILE GROUP
41	Automobile Dealers, Garages, Service Stations and Accessories
	5. FURNITURE AND FIXTURES GROUP
51	Auctioneers, Antique and Art Dealers, Second Hand Stores
52	Furniture Dealers, Household Furnishings, Cabinet Makers and Upholsterers
53	Radios, Radio Repairs, Musical Instruments, Music Dealers
54	Office Furniture, Fixtures, Supplies, Stationers, Book Sellers
	6. BUILDING MATERIALS AND CONTRACTORS GROUP
61	Builders Supplies, Contractors, etc.

A PROVINCIAL SALES TAX

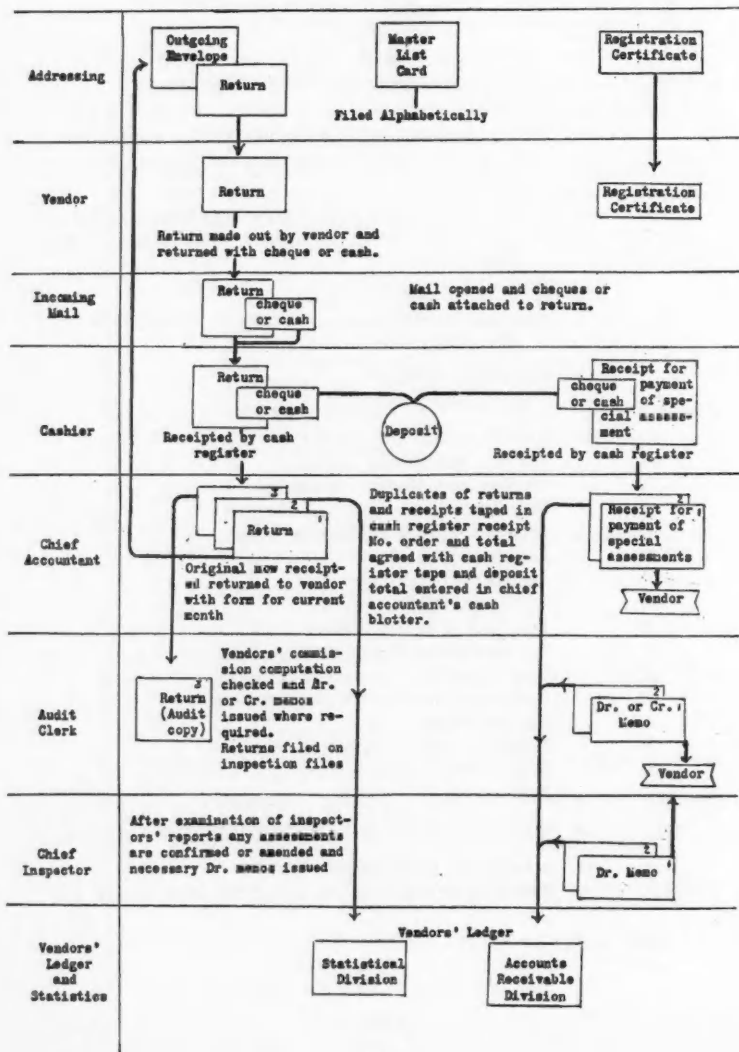
- | | |
|------|---|
| 71 | 7. LEATHER GROUP |
| | Leather Goods, Harness Makers, Boot and Shoe Stores and Repairs |
| | 8. MACHINERY GROUP |
| 81 | Blacksmiths, Machine Shops and Foundries |
| 82 | Farm and Industrial Machinery |
| | 9. DRUGGISTS GROUP |
| 91 | Druggists, Surgical and Dental Supplies |
| 92 | Opticians |
| | 10. NEWS AGENTS AND TOBACCONISTS GROUP |
| 101 | Tobacconists, News Agents, Bowling Alleys, Billiard Halls |
| | 11. PHOTOGRAPHERS AND SIGN MAKERS GROUP |
| 111 | Photographers, Photo Finishers, Photo Engravers, Sign Makers |
| | 12. SPORTING GOODS GROUP |
| 121 | Sporting Goods, Gunsmiths, Motor Cycles, Bicycles and Accessories |
| | 13. PRINTING GROUP |
| 131 | Printers and Publishers |
| | 14. MISCELLANEOUS GROUP |
| 141A | Barbers and Beauty Shops |
| B | Florists and Market Gardeners |
| C | Hatcheries |
| D | Jewellers and Watchmakers |
| E | Kennels |
| F | Pedlers and Salesmen |
| G | Stone and Marble Works |
| H | Tent and Awning Makers |
| I | Transportation Companies |
| J | Undertakers |
| K | Provincial Government Departments |
| L | Private Sales |
| M | Bazaars, Picnics, Carnivals, etc. |
| N | Miscellaneous (Unclassified) |
| | Mail orders |
| 151 | 15. WHOLESALE AND MANUFACTURERS GROUP |
| | 16. NATURAL RESOURCES GROUP |
| 161 | Grain Elevators, Coal, Ice, Flour and Feed Stores, etc. |

THE CANADIAN CHARTERED ACCOUNTANT

SALES TAX ACCOUNTING

EXHIBIT "A"

FLOW CHART



A PROVINCIAL SALES TAX

31-316-2000

SHEET _____

EXHIBIT "C"

Mr. John Jones,
Jones General Store,
Wetaskiwin, Alberta.

DATE	FOLIO	SALES		DEBIT STAMPS ISSUED	CREDITS		BALANCE
		EXEMPT	TAXABLE		CASH	COMMISSION	
							1
							2
							30
							33
							34
							35
							36
							37

EXHIBIT "D"



GOVERNMENT OF THE PROVINCE OF ALBERTA

TREASURY DEPARTMENT — SALES TAX BRANCH

Qu'Appelle Building — EDMONTON

THE ULTIMATE PURCHASER'S TAX ACT

VENDOR'S RETURN

31-316-2000

JUNE

Mr. John Jones,
Jones General Store,
Wetaskiwin, Alberta.

1937

Commission 5%

- (1) Total amount of sales for the month, including cash, credit and instalment sales and also commodities taken from stock by the vendor for his own use or consumption \$ _____
- (2) Amount of sales not subject to tax \$ _____
- (3) Amount of sales subject to tax \$ _____
- (4) Amount of tax collected \$ _____
- (5) Deduct Commission at rate stated above \$ _____
- (6) Amount of tax remitted herewith \$ _____

NOTE: Do not include in the above statement the value of commodities sold for resale and non-taxable labour charges.

RECONCILIATION OF TAX RECEIPTS

Total value of receipts on hand at beginning of month	\$ _____
Add value of receipts received from Department during month	\$ _____
Total receipts to account for	\$ _____
Deduct value of receipts on hand at end of month	\$ _____
Value of receipts issued to purchasers during month	\$ _____

I hereby certify that this return is a full and complete disclosure of sales, ultimate purchaser's tax collected and receipts issued during the period covered by this return.

SIGNED _____

TITLE _____ DATE _____

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SOME PROBLEMS AS BETWEEN BUSINESS AND GOVERNMENT*

Kris A. Mapp, F.C.A., Toronto

In considering what I might talk to you about for a short time today, I reflected on the tremendous financial contribution business is making towards the conduct and upkeep of government in this country. The Minister of Finance in his budget speech of June 16th last, estimated the total ordinary revenues of the Dominion Government for the fiscal year ending March 31, 1938 at 510 million dollars. Similar revenues for the past ten years have amounted to well over 3¾ billion dollars and, in addition, the net debt of the Dominion has increased during this period by 872 million dollars, indicating that the revenues of the Dominion Government, large as they are, have not been sufficient to take care of its financial requirements and obligations.

When one analyzes the sources of the government's revenue, one readily appreciates that by far the greater portion is derived from taxation. During the last year it amounted to 448 million dollars or 88%, the sales tax being the biggest contributor with 138 million dollars. Time does not permit me to deal with the anomalies and inequities of this tax. The point on which I wish to lay emphasis is that, not only do business and industry bear a very heavy share of this load, but in addition they act as unpaid collectors of this tax for the Government and in many cases are required to pay the tax to the Government before collection is effected and in some cases where collection is impossible.

Let me refer just briefly to the income tax which produced for the Federal government last year 120 million dollars, and I believe that the industrial system, in all its ramifications, is one of the principal sources of this tax. The rate of taxation for corporations which in 1917 was 4% has gradually been increased until to-day it stands at 15%. And yet we hear little by way of complaint from business men even though they know that a very binding partnership exists as between government and business when business is making a profit and complete dissolution of the partnership on the part of government when business sustains a loss.

*An address given before the Kiwanis Club of Halifax on 22nd August 1938.

If you add to these enormous revenues other forms of taxation which produced 190 million dollars last year for the Federal Government and if you also consider the amounts exacted from business by provincial and civic governments and also the large sums expended by business, not through the agency of government, for objects the cost of which otherwise might have to be borne by government, you readily appreciate the tremendous contribution business is making not only for the conduct of the affairs of government but also for the cost of government in this much over-governed country.

And so I want to ask you the question—what is government doing to solve some of the major problems of business in return for all that business contributes to government?

Duplicate and Overlapping Taxes

Let me take you for a few minutes into the field of taxation with all its uncertainty, duplication and overlapping. In Ontario there is the Corporations Tax Act which exacts from incorporated companies a tax on capital, a tax on each office or place of business and a tax on net revenue. This Act also embraces financial institutions, railways, gas and electric companies, and other types of specialized businesses though the measure of taxation is somewhat different. Then there is the Income Tax Act (applicable to individuals), which follows very closely the form of the Dominion Income War Tax Act, the rates being one-half those of the Federal government. In the municipal field, apart from taxes on property and business taxes, there are additional taxes on income of corporations.

Turning to Manitoba there are the taxes levied under the Corporations Taxation Act and the Income Taxation Act. Similar taxes exist in the other Provinces and in addition Saskatchewan and the City of Montreal have enacted Sales Taxes. Some of these taxes apply regardless of the existence of profits from which to pay them, but I will not burden you with unnecessary detail. The point I wish to emphasize is that all levels of government, Dominion, Provincial and Civic, have invaded the same fields of taxation, with all the attendant chaos, duplication, and unnecessary expense in effecting collection.

There is almost every conceivable lack of uniformity in the information required in taxation returns, with the result that separate accounting operations must be carried out and to some extent separate records must be maintained for each taxing body at a very considerable cost to business. While we must recognize that the financial needs of any taxing jurisdiction must determine the rates of its taxes and that accordingly uniformity in the rates of Dominion and Provincial taxes can be scarcely hoped for, it seems hard to believe that uniformity of information required and acceptance of one inspection by all taxing authorities could not be made a reality if there were a sufficient will on the part of government to accomplish these objects.

I believe one of the major problems faced by any business whether operating provincially or inter-provincially is meeting taxation and complying with the legislation and regulations of the Dominion government and Provincial governments up to nine in number. The taxation laws and regulations of our ten major governments, applicable to business, are marked by a lack of co-ordination, a lack of uniformity and unfortunately, in some cases, by a positive discrimination that hampers seriously the efficient operation of inter-provincial trade to the detriment of the whole economic life of Canada. Business is not given the conditions which enable it to make its maximum contribution to our national life, a contribution which I believe to be a material factor in the solution of many of our problems. Please do not misunderstand me. I am not seeking to plead a special case for tax relief to business, for, on the contrary, I believe that business, while hoping for any gross tax relief which easier revenue requirements permit, is prepared to pay its full share of taxes. I am only urging a tax adjustment, a levelling of extremes, and the removing of anomalies and duplication which will place business on a uniformly intelligent basis of taxation and enable it to operate efficiently and properly and make an increasing contribution to our national economy.

The Canadian Manufacturers' Association in its submission to the Royal Commission on Dominion-Provincial Relations stated:—

"It is a truism to say that the ideal form of taxation from industries point of view is one that is marked by a maximum of certainty, simplicity, uni-

formity, equality and finality. The object of what follows will largely be to show that our present system of taxation in Canada falls lamentably short of this idea."

and after citing several examples continues—

"From what has been said it will be clear that the ideal system from industries point of view would be one providing for the raising of the necessary revenue by means of minimum number of taxes collected by a minimum number of agencies, preferably one."

Surely gentlemen common business sense demands a readjustment of these matters and I believe that common sense will eventually triumph.

Succession Duties

Let us take just a brief glance at the question of Succession Duties, and when one contemplates the application of these duties, one is inclined to wonder whether we live in a Canada composed of one country or in a Canada composed of nine countries. While all provinces follow the principle that the domicile of the deceased entitles the Province in which decease occurs to levy a succession duty, they, in addition, claim the right to collect a succession duty on the succession or transmission of securities when the head office, or in some cases the transfer office, is located within the taxing province although the deceased was domiciled out of the province at the time of death, with the result that double succession duties occur in numerous instances. I think that governments were particularly concerned with the far-reaching effects of this type of taxation, for at an Inter-Provincial Conference held in Ottawa in June 1926, the following resolution was adopted:—

"That it is the opinion of this conference that all provinces should take the steps necessary to avoid multiple taxation in the imposition and collection of Succession Duties."

A number of the provinces then entered into reciprocal arrangements and considerable progress was made in pursuit of this object; but last year the arrangements were cancelled, and the present position therefore is that, after the provinces in 1926 committing themselves to the principle of avoiding multiple taxation in the imposition and

collection of Succession Duties, the progress and advances made have been completely swept away. One can but wonder why.

There is one other aspect of this subject to which I want to draw your attention. This is the effect multiple succession duties have in deterring the movement of investment and wealth from one province to another. Potential penalties in the form of multiple duties, when a person dies domiciled in one province with money invested in another, are powerful factors in causing owners of wealth to follow a policy of confining investments to the province of their domicile or at least to the limited types of more general investment where no question of multiple succession duties can arise. In practical operation this is an influence tending to bottle the accumulated wealth of certain provinces within them. A portion at least of this wealth, and perhaps a substantial portion, is thereby prevented from taking advantage of undoubted investment possibilities, particularly in the development of natural resources, in the more outlying provinces which so need an influx of wealth for the stimulus it will give their economy and the greater taxation resources it will make available to their governments.

I believe that Provincial governments can make a tremendous contribution, both in their own and taxpayers' interest, by a proper co-ordination of the principles in determining jurisdiction to levy succession duties so that there will not be more than one duty imposed on any part of the Estate or any part of the assets thereof.

Public Accounts

Let me now refer, and only briefly, to the published accounts of governments—the accounts wherein they report on their stewardship of public moneys. Governments, both Dominion and Provincial, have enacted legislation, and quite properly so, making very explicit the manner in which accounts of incorporated companies are to be presented to the shareholders. The Federal government says that incorporated companies must state the basis of the valuation of their inventories and fixed assets—they must disclose the salaries paid to directors and executive officers and the amount paid for legal fees—they must further distinguish between capital surplus, distributable surplus and earned surplus. I am not taking issue with any of these things, but

I raise the question, what regulations are governments imposing upon themselves in the presentation of their financial accounts so that they will be readily and easily interpreted and understood by the business men of this country? In an ideal state the citizens would know what each of their governments was doing and would know how their finances compared with those of previous years and those of comparable governments. Admittedly this is not the case today. Contradictory statements are bandied about as to whether debts have increased or decreased during a year and whether surpluses are not really deficits. As a result, there is a scepticism about governmental finance which will produce in time, if indeed it has not already done so, an indifference to it.

Admittedly a standardized accounting technique for the various governments in Canada is not easy to attain. Special functions undertaken by certain governments and the multiplicity of services for which all governments have become responsible, do not make for simplification. Nevertheless, business has overcome comparable problems and there are now definitely accepted accounting principles in business which are used to determine financial results, but they do not always appear in governmental statements. In contrast to the generally accepted and readily understandable forms of statements now used by business, the accounts and statements presented by some of our governments are extremely difficult of interpretation. Look at the Public Accounts of the Dominion of Canada. I only wish that every business man in this country had a copy in his possession. There we see Funded Debt of over $3\frac{1}{4}$ billions of dollars and no provision made for the accrued interest thereon. Could the Directors of businesses present such a statement to their shareholders? Yes, but only with the probability of finding themselves in the law courts for so doing. Looking again, we find the gilded term "Consolidated Fund." One might easily consider this to be a surplus, but on closer analysis it proves to be an accumulation of deficits which in 1937 had amounted to over $1\frac{1}{4}$ billion dollars. Surely, gentlemen, we are entitled to place some other meaning on the word "Fund" than a series of deficits. But this is not all. Many large items are not included in this so-called fund.

The Railway Problem

I quote you only one as it brings me to the concluding remarks of my talk. "Non-active loans to Railways totaling 655 million dollars," the recovery of which is well nigh impossible. Perhaps you say, why bring up the railway question? Firstly, because I am beginning to wonder whether government has the will to carry out measures which would bring relief and, secondly, on account of the indifference of the great mass of our people to its national importance and economic implications because it does not touch the average individual like the problem of unemployment, except in direct or indirect taxation, and then it is sufficiently disguised to avoid recognition. It cannot be denied that this problem is an unique one which hangs over the economic life of our country like a black ominous cloud; neither can it be denied that little is being accomplished by government to stop the dissipation of over a million dollars every week. Nothing could be gained at the moment by attempting to trace the history of the problem; nothing could be gained by attempting to attach responsibility for it. We are equally culpable and the least we can do is to realize our culpability and shoulder the responsibility for resolving the issue by constantly bringing the problem to the forefront in the hope that government will realize its responsibility and consider the problem in the light of its actual importance to our national welfare.

The deficits of the Canadian National Railways over the past fifteen years have totalled over 500 million dollars and if we add to this the unpaid interest due the government on loans advanced by the Dominion to the railways, we arrive at a staggering deficit for the fifteen years of well over a billion dollars. What is the government doing to effect a solution? The last effort, or the last effort of which we have any intimate knowledge, was through the Duff Commission in 1931-2. The commissioners at that time stated in their report—"In a little more than ten years, the whole railway situation has passed from a position of manageability and moderate cost, to one of financial confusion and over-extension."

The Commission had before it two main proposals for its consideration. One of these was for the adoption of a system of unification for administrative purposes and the

other for the adoption of a system of co-ordination and co-operation. Chiefly because of some monopolistic features of the first proposal, the Commission adopted the second, that of co-ordination and co-operation, and it was estimated that such a policy would result in economies which would amount to approximately \$30,000,000 annually. Recommendations were made to the Government as to the methods to achieve a plan of this character and Parliamentary sanction was given thereto. It is history now that the results have been a dismal failure and the experience under this plan is now of sufficient duration and of such a nature as to impel reaching the conclusion not only that it has not solved, but also that it will not solve, the Railway problem.

Recently we have read of a Senate Inquiry and one cannot help but congratulate the Senate in its attempt to throw light on the subject. But what transpired? As I read my daily newspaper, I could not help but arrive at the conclusion that both railways approached the inquiry with a feeling of antagonism one to the other. Figures and estimates of savings submitted by the President of one railway were contradicted by the President of the other. The President of the publicly owned railway took credit for the fact that the operating revenues of the Canadian National exceed its operating expenses, and that the deficits arise not from the operations but from the heavy burden of interest charges. Of course, we all know that, but how can you run a railway without debt and its consequent interest charges?

Gentlemen, is this the way to solve the railway problem? Is this the way to stop the seepage of over a million dollars every week from the resources of our taxpayers? As I travel the length and breadth of this country, I find a growing and ever-increasing impatience on the part of business men towards the lassitude, the indifference, the inertia of government to what might be termed one of our greatest tragedies. The time has come when all political parties must get together in one determined effort to solve this problem and put a stop to piling up a burden so gigantic that it can only be assessed in astronomical figures. The continued pressure of the business men of this country will bring, I believe, the government to a realization of its responsibility and then Parliament in turn will, under the tremendous powers which it enjoys, be able to impose its will on the railways themselves.

I have endeavoured to bring before you some of the major problems as between government and business which remain unsatisfactory and unsolved. But I believe their solution is not impossible. I read with great interest the excellent brief submitted to the Rowell Commission by your distinguished Prime Minister, and I could not help but be impressed with its sincerity, its clarity of thought and its expressions of willingness to co-operate. This is what we need. No super-human powers are called for and the solution of these problems will be reached in the exact ratio of the will of governments to reach it. It therefore behooves us to constantly bring these issues to the fore-front, to constantly stress their importance, and, in so doing, we shall eventually strengthen the will of governments and thereby make our contribution to the better economic welfare and happiness of our people.

IMPROVEMENT IN FINANCIAL ACCOUNTS*

Practical Lines of Improvement

By George O. May, F.C.A., New York

OUR TASK today is to sum up the discussion of the last two days, and to suggest the direction which efforts to improve financial accounts should take. First, what is our objective? In the case of the Interstate Commerce Commission and the Bureau of Internal Revenue, to which I referred in my last lecture, the objectives are clear—in the one case, it is to secure healthy development of the railway transportation system and maintenance of rates that will be compensatory to the carriers and not unduly burdensome on the commerce of the country. In the case of the Bureau of Internal Revenue, it might be said to be to secure the collection of the revenue with such degree of justice to the taxpayer as seems to it to be compatible with that object.

Public Interest in Corporate Accounts

What is the exact character of the public interest in the question of financial reports and accounts which should

*The third in a series of three lectures delivered on the A. Lowes Dickinson Foundation, Graduate School of Business Administration, Harvard University. The first and second in the series appeared in our July and August issues.

influence future developments in this field? I have pointed out that in England the general theory of law even today, when large publicly owned corporations exist there as here, is that in the absence of fraud, and subject to proper protection of creditors, corporations should be allowed to manage their own affairs, and particularly to determine the amount of profits available for distribution in dividends, in accordance with their own articles of association, which constitute the contract between their shareholders and are a matter of public record.

Obviously, the day has passed when any such *laissez-faire* policy could be regarded as acceptable in our country. However, in any procedure we may propose we should at least have some clear idea of the nature of the public interest which calls for limitations on such freedom of action on the part of stockholders and of the directors elected by them. I stress this point because it seems to have been frequently lost to sight in the extensive discussions of the last few years of the subject with which we are dealing. Criticisms have often been based on the fact that methods have differed, without regard to the question whether in a particular case the method followed was prejudicial to any legitimate interest. These criticisms have resulted in many footnotes to published accounts—footnotes not always lucid, and the gradual accumulation of which has undoubtedly tended to the confusion of stockholders and investors. Preoccupation with the importance of not misleading investors has obscured the desirability of enlightening them.

You will have gathered from the preceding lecture that while I recognize the value of a certain degree of uniformity, I do not believe complete standardization of accounting in the industrial field to be either desirable or attainable at this time, if ever. You will have observed, also, that it has not been attained in the past, even under so-called uniform classifications. In these days of wishful thinking, however, the idea that standardization can, and should, be achieved persists, especially outside the accounting profession. This is not surprising; we are all inclined to underestimate the difficulties of other people's problems. I recall that at the last annual meeting of the American Institute of Accountants a distinguished practitioner proposed that the Institute should undertake to formulate a model federal

income tax law, and expressed the belief that it could be made short and simple; I assume he also contemplated that it should be reasonably equitable. We can hardly complain, if others display a similar blithe optimism regarding our problems.

The usefulness of financial accounts may be increased by improvements in either their substance or their form. Let me first summarize the position regarding changes in substance which I discussed in my last lecture and then turn to the question of form, which I think presents both less difficulty and greater possibilities.

Specific Problems Further Considered

As I have said, I see no escape from the conclusion that continuity in accounting must be preserved, and that accounting in respect of fixed assets must necessarily be in general based on cost. I realize that from the standpoint of the new investor this is not altogether satisfactory, but it is obviously impossible to take cognizance in accounts of the fact that different stockholders acquired their stock interests at different times. Acceptance of cost as the basis for property accounts implies that in computing income depreciation will in general be based on cost rather than on present value. As indicated in my second lecture, I believe that it should be permissible, and that it is in the general interest that where the value of depreciable property has, in fact, fallen far below original cost, and the fall seems likely to be permanent, the downward adjustment of the property account should be facilitated. I think, however, it is undesirable and not wholly accurate to state, as some corporate officials have stated in recommending such readjustments of book values, that they imply no real loss to the stockholder. Even if the readjustments do not themselves imply a loss, the declaration of dividends out of earnings based on the reduced charge for depreciation in subsequent periods carries that implication; for the original stockholder is receiving as income in such a dividend part of that which was originally his capital and which prior to the adjustment had to be maintained out of income before any dividend distribution could be made.

The question may arise whether in the reverse situation capital values should be written up. Logic may suggest that they should be, but personally I should wish to be very

fully assured of the reality and probable permanence of an increase in value before I should favour reflecting it in the books of the corporation. It will do no harm to reiterate that I am wholly opposed to the idea of writing property up and down at more or less frequent intervals as costs of replacing it fluctuate. I would also draw your attention to another practice sometimes adopted of placing depreciating property on the books at a very low or even nominal figure and making in the income account only a small provision, if any, for depreciation of this property. Clearly this practice, while having a specious appearance of conservatism in the balance sheet, results in an overstatement of income and is indefensible.

A step which I should regard with satisfaction would be the general acceptance of the practice of excluding from the income account capital gains and losses realized otherwise than in the ordinary course of a company's business—indeed, I believe that even in the case of investment trusts, in which capital gains and losses might be said to be normal incidents of the business, it is preferable to exclude them from the ordinary income account. My reason for these views I have set out on other occasions. It should also be recognized that to a corporation its own capital stock can neither be an asset nor produce income.

A legitimate question may be raised whether the illogical, if conservative, practice of taking inventories at cost or market, whichever is lower, is appropriate in the preparation of an income account which is designed, at least in part, as an indication of earning capacity. There is a substantial argument in favour of taking the inventory for the purposes of the income account uniformly on the basis of cost, making any adjustment to market value which may be necessary for the purposes of a statement of quick assets or a balance sheet, through another account. This procedure is, however, open to the objection that it permits the operating manager to improve his income statement by the production of goods for which there is no ready or certain market.

In regard to the question of premature retirements, correctness of estimates, and delayed items which I discussed yesterday, I confess I see no choice but to sanction alternative treatment according to the facts of the individual case. In this matter investors cannot secure protection through

a uniformity which is likely to be superficial rather than real; they must rely on the honesty and competency of those responsible for the preparation and audit of the accounts.

The Cardinal Virtues: Consistency, and Fair Disclosure

Before leaving this branch of the question I should emphasize, first, the importance of consistency in accounting from year to year, and, secondly, the desirability of disclosing any exceptional items in such a way that those who may deem appropriate some treatment of an item other than that adopted in the accounts may be enabled to make their own adjustments. If you read the correspondence between the New York Stock Exchange and the American Institute of Accountants, or the report of the Gifford Committee, to which I referred in my first lecture, you will note the growing emphasis on the importance of consistency in accounting, which has been stressed in the regulations under the income tax law since 1918. No better rule could be laid down to cover general accounting methods than that laid down by the Bureau of Internal Revenue in relation to inventories, which I quoted in the preceding lecture, and which with the slight changes necessary would read as follows:

In order clearly to reflect income the accounting practice of a registrant should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of accounting, so long as the method used is in accord with the broad principles of accounting practice.

Separate disclosure of items in regard to the treatment of which there is room for legitimate difference of opinion will go far to meet the criticism of those who may disagree with the method actually adopted. In general, anyone competent to express agreement or disagreement on such a question is qualified to make any restatement of the accounts which may be necessary to meet his own point of view.

Paramount Importance of the Income Account

Turning now to questions of form: If we stop to consider what the investor is really interested in, the paramount importance of the income account and of statements of quick assets and liabilities at once becomes apparent,

this importance resting on the simple ground that earning capacity and solvency are the most essential elements in commercial prosperity. I was sorry to see Sir Josiah Stamp emphasizing, recently, the importance of the balance sheet, because to my mind in England the balance sheet has been used by the secretive company director as the red herring to distract public attention from the income account, which I am sure Sir Josiah would agree is even more important.

I have on other occasions drawn attention to the fact that the English law until as lately as 1928 contained no statutory requirement for the submission to stockholders of anything in the nature of an income account, but required only a balance sheet. This has seemed to me the more surprising because a clear appreciation of the relative importance of the two statements is indicated in the language of the model form of articles of association which was attached to the Companies Act of 1862 and known as Table A. It is worth while to quote some of the articles of that table which, it should be pointed out, were suggestive and not compulsory:

Art. 79. Once at least in every year the directors shall lay before the company in general meeting a statement of the income and expenditure for the past year, made up to a date not more than three months before such meeting.

Art. 80. The statements so made shall show, arranged under the most convenient heads, the amount of gross income, distinguishing the several sources from which it has been derived, and the amount of gross expenditure, distinguishing the expense of the establishment, salaries, and other like matters: every item of expenditure fairly chargeable against the year's income shall be brought into account, so that a just balance of profit and loss may be laid before the meeting; and in cases where any item of expenditure which may in fairness be distributed over several years has been incurred in any one year the whole amount of such item shall be stated, with the addition of the reasons why only a portion of such expenditure is charged against the income of the year.

Art. 81. A balance sheet shall be made out in every year, and laid before the company in general meeting, and such balance sheet shall contain a summary of the

property and liabilities of the company arranged under the heads appearing in the form annexed to this table, or as near thereto as circumstances admit.

I think we should today accord to the income account the priority in importance which is given to it in these articles.

Supplementary Accounting Statements

The Securities and Exchange Commission has in its regulations added to the standard set of major financial statements an account of the changes in reserves during the period for which the report is made. Such a statement throws a valuable light on the income account and is, I think, an addition to the sum of financial information which is of great importance and upon which the Commission is to be warmly congratulated.

Another valuable form of statement which might well be more generally adopted is the summary of resources and their disposition, such as the United States Steel Corporation has for many years published.

In my first lecture, I drew attention to the new importance which the income account has acquired as an index of earning capacity and hence of capital value, in addition to its former importance as a guide to the amount of profit available for distribution in dividends. Recognition of this new purpose, coupled with the demand for reports covering periods even shorter than a year, has led more and more to the use in the income account of accruals, estimates, and budgetary provisions in lieu of amounts actually received or expended, as the basis for the charge or credit in the particular period covered by the statement. Obviously this practice, while in some respects advantageous, has its own dangers in that it tends to make an income account a statement of averages rather than of current events. Even if it may have made the income account more useful from the standpoint of the person who is considering buying or selling stock in the corporation, which is arguable, it has rather distracted attention from the fact that a sound dividend policy permits the declaration of a dividend only when the company possesses cash resources which justify its payment as well as a surplus or undivided profits account available for appropriation. The statement of resources and their disposition answers the vital question—what has become of the cash?—and affords a useful corrective to views

formed on the basis of an income account which perhaps unduly emphasizes net earning capacity as distinguished from net current receipts of income.

I should perhaps explain that in speaking of dividends I have in mind true cash dividends, and am not concerned with any of the mongrel types of distribution which were common during the boom period and which, although regarded by many stockholders as dividends, were in reality more in the nature of split-ups; nor with the new type of dividends resulting from the passage of the undistributed profits tax law, some of which are scarcely more than certificates of undistributed profits.

If the investor were given:

- (1) a reasonably full and fair income account,
- (2) a statement of quick assets and liabilities,
- (3) a summary of changes in reserves, and
- (4) a summary of resources and their disposition,

the balance sheet would then become of secondary importance to him and the fact that in the balance sheet assets and liabilities, if those headings are to be retained, are stated on various conventional bases and not on any uniform theory of values would become of minor importance. It might, however, still be desirable to classify the assets and liabilities therein according to the different bases on which they are stated, or at least to make clear in each case the basis employed.

A minor change in accounting practice which I should like to see made effective is the elimination of the word "earnings" except in the case of companies engaged in rendering service. I think the term "undivided profits" is distinctly preferable to the term "earned surplus," which often includes credits which cannot be said to have been earned in any legitimate sense of that word.

Another change which, I think, is clearly called for is the separate disclosure of the figure at which goodwill and intangible values are carried by the corporation, and the same is true of land. I favour this proposal on a ground which is perhaps different from the position usually taken. I do not suggest that the value of intangible assets is any less real than that of tangible assets, and I would not even undertake to demonstrate that from the standpoint of value the two can be accurately separated—indeed, the validity

of any separation of values is doubtful, if the premise be accepted, as I think it must be, that the value of capital assets depends primarily on earning capacity. My view is, rather, that while the value of the capital assets depends on the earning capacity, the amount of the net profits shown in turn depends, in a measure, on the provisions charged against income for exhaustion of property (commonly called depreciation), and these provisions in turn depend upon the figure at which the capital assets are carried on the books. Hence it is, I think, of material importance to the investor to know how much of the book figure of capital assets represents sums in respect of which depreciation is being charged and how far it represents items, such as intangible values or land, on account of which no depreciation charge is being made or is customarily regarded as necessary.

In the ways which I have suggested and in similar ways I think improvements can be made in respect of the form in which annual accounts are presented which would be extremely valuable to the investor. Substantial agreement as to the changes that are desirable could, I think, be reached without great difficulty, and the changes could be made effective at an early date without causing any disturbance to existing reporting methods, except the minor inconveniences of restating the accounts for a year or two in the past to facilitate comparison.

I hope that the Securities and Exchange Commission will seek improvement in financial accounts through sympathetic and patient encouragement of progress along these general lines and that it will not attempt to lay down rigid rules of accounting as it has sometimes been suggested that it should do.

One consideration alone seems sufficient to demonstrate the unwisdom of the latter course. For many years we have had accounting rules laid down by at least two Governmental bodies—the Interstate Commerce Commission and the Bureau of Internal Revenue—and new regulating bodies are creating further classifications. I believe anyone familiar with the facts will agree that, in general, industrial accounting is today more conservative than the accounting that is prescribed by the Interstate Commerce Commission, or that permitted by the Bureau of Internal Revenue. If, therefore, the Securities Commission should undertake to lay down a new set of rules, it would be facing an extremely

embarrassing dilemma—it would either have to lower the standards of conservatism already in effect in the commercial world or establish rules on a higher standard of conservatism than those established by other Governmental bodies which have been dealing with the subject for many years. Clearly, in such a situation it would not be doing its full duty to investors unless it should elect the second alternative. Equally clearly, however, this would create awkward situations, and its course might easily fail to find support in the courts, since it would be difficult to show upon what ground it could justly make mandatory procedures which were not required or even sanctioned by another Governmental body. I am convinced that the Commission would do well to avoid such a dilemma, if possible, and I am convinced, also, that there is no reason of public policy today which imposes on it an obligation to face that dilemma.

Annual Reports v. Prospectuses

I have considered up to this point the question of financial accounts required for the purpose of annual reports of established companies; and I should like to make it clear that in referring to the effects of the Securities Acts I have been considering only the case of companies of that character, that being the field of accounting in which I have some familiarity. The regulation of new and speculative promotions presents entirely different problems of which I cannot claim to have any special knowledge. I do not propose to discuss at length the question of accounts required for a prospectus, but it seems desirable to make a brief reference to that question and particularly to emphasize the difference between such accounts and accounts required for the ordinary purposes of an annual report.

The nature of a prospectus is clear and single—it is a representation made in connection with an offer to sell. The reader of it is concerned only with the future. Accounts covering a past period are of value to him in so far as they throw light on the probabilities of the future. In so far as they are purely historical they are devoid of any interest to him. As I have indicated, I believe that an annual report should be regarded as primarily a historical report to stockholders. The distinction which I have here suggested seems to me to have been obscured in the Secur-

ities Act of 1933, and practically ignored in the Act of 1934. Under Section 18 of that Act, executives of a corporation who have issued a report which is found to be misleading within the terms of the section, are subjected to a potential liability to those who have bought or sold stock in the corporation. This section seems to me to be open to criticism—because it treats a periodical report too much as if it were a new edition of a prospectus instead of a historical report, and because it assumes a much closer relation between market transactions in stock of a corporation and periodical reports than the facts warrant. On the first point, it is, I think, regrettable that the Act should thus encourage, if it does not compel, the corporate executive to keep his eye on the stock market when he is preparing his report, and to prepare it with the trader in the stock of his company rather than the permanent investor in mind. On the second point, I think all the evidence tends to show that purchases of stocks are, in general, based far more largely on expectations for the future than on records of the past, and upon hopes of capital appreciation than on prospects of income yield. Some of you may perhaps have read the brilliant and entertaining discussion of this question which is contained in Keynes's recent book.⁵

The form of accounts presented in a prospectus should be determined by the purpose of that document. To accomplish this result it is necessary to recognize frankly that the statement which is appropriate for a purely historical report on the past is not always the right statement for guidance for the future, especially if changes in capitalization, property valuation, or other essential elements of the situation have been or are being effected. In so far as the accounts deal with past years in respect of which annual accounts have already been issued, not only should it be permissible, but it is desirable, that those accounts should be reconsidered and, if necessary, adjusted in the light of any additional information which has become available since they were prepared. At the present time the customary method of presenting financial information in prospectuses is admittedly unsatisfactory. Too often the investor is given a mass of information and explanations from which he is left to draw his own conclusions. Even

⁵*The General Theory of Employment, Interest and Money*, Chap. XII, *passim*.

those possessing technical qualifications have difficulty in interpreting the income account, followed by pages of footnotes, which is frequently found in the prospectus of today. This, I hope and believe, is merely a passing phase, though wholehearted and sympathetic co-operation between executives, lawyers, accountants and the Commission will be needed to evolve a method of presentation which will be really enlightening to the investor and afford proper protection to those concerned in the issue of the prospectus against the liabilities which they may incur under the existing law.

Dangers of Premature Crystallization of Practice

In the narrower field of financial accounting as in the broader field of regulation of security issues and annual reports as a whole, we are clearly today at a tentative stage and it would be in the highest degree unwise to attempt to stabilize the law and practice in either field at the point which we have now reached. In recent years the trend in both fields has been given a new impetus and a new and wiser direction. In respect of fulness and fairness of disclosure, I believe our standard is today among the highest in the world; what is needed, now, is the elimination of superfluous detail, greater simplicity, and clearer cut statements of honest and informed opinion on material questions. It would be interesting to pursue this question further, but to do so would carry us far from our original topic.

In conclusion, may I express my concern that you should take away from these lectures a just appreciation of both the usefulness of accounts on the one hand, and the necessary limitations on their significance on the other. They are accounts of happenings in a world of business which is subject to constant and sometimes violent change and full of uncertainties; naturally, they cannot rise higher in the scale of certainty than the events which they reflect. Necessarily, also, they involve the use of conventions and estimates, and the supreme virtues in them are consistency and fair disclosure. It is because I believe that recent years have brought a far wider recognition of these essential characteristics of accounts than previously existed that I look hopefully for improvement in the future. Not that the record of development in the past has been unsatisfactory—indeed, considering that the modern corpor-

ation and the profession of accounting have both been in existence for only a half century or so, I think the fact is otherwise.

Comparison has been sometimes made between the progress achieved in establishing standards in the accounting and in the engineering world, respectively, but it is obvious that the engineer, in computing his standards of construction, is dealing with the physical world, while in financial accounts the accountant is dealing with things metaphysical. Since accounting is a tool of business, and since courts have laid down the rule that what is good accounting should be determined by the best practices of business men, a fairer comparison is between the development of corporate accounting and that of commercial law. In any such comparison it must be remembered that the lawyers have the inestimable advantage that there is always a court composed of members of their own craft which is in a position to lay down rules that will be binding not only on members of the craft but on all others, and also that legislative bodies usually consist more largely of lawyers than of any other class. Bearing in mind this difference, and considering the unsatisfactory state of the law of valuation to which I have referred, and which you will find more fully set forth in Professor Bonbright's work; or considering the history of, let us say, the development of the law of negotiable instruments from the decisions of Lord Mansfield which began the process of co-ordination in the third quarter of the eighteenth century⁶ to the formulation of a proposed uniform law in our country in the last years of the nineteenth century⁷ and its gradual acceptance by the States and Territories over a period of thirty years thereafter, I do not think the accounting profession in America has any reason for dissatisfaction at what has been accomplished in the field of corporate accounting during the half century or less of its existence.

⁶"In *Heylyn v. Adamson* (1758) Lord Mansfield brought order out of chaos." (Fifoot, *Lord Mansfield*, p. 91).

⁷The Uniform Negotiable Instruments law was proposed by the Commissioners on Uniform State Laws in 1896, and its adoption became complete in 1930.

THE EFFECT OF DEBT LEGISLATION

SINCE the beginning of the depression, when debtors generally found it difficult to meet their contractual obligations, the Provincial and Dominion governments have passed legislation of a greater or less radical nature, designed to protect debtors but too often in disregard of the rights of creditors.

The Farmers' Creditors Arrangement Act (Dominion) was passed with the greatest of good intentions—to retain the farmer on the soil and to give him the benefit of a reduction in his debts to the amount his creditors might reasonably expect to realize on a liquidation in bankruptcy. In many cases the result has been to create an equity for the farmer at the expense of creditors no better able to bear the loss, and the mere existence of the Act has prevented younger and frequently more able farmers from obtaining sufficient credit to begin farming operations for themselves.

The original sponsors of the Act now acknowledge how prone to abuse an Act of this type may be and this in part accounts for the decision of Parliament to bring its operations to a close within a year, except in the Provinces of Alberta and Saskatchewan.

In British Columbia, Ontario and Quebec, there are mortgage moratorium laws forbidding creditors to collect the principal amount of their debts, and lulling debtors into a false sense of security that if they pay carrying charges they are not running further behind in the payment of their obligations. They fail to appreciate the effect of depreciation upon the security for the debt which will in time wipe out their equity.

In Manitoba, Saskatchewan and Alberta, there is debt adjustment legislation covering a wider field of debts and preventing actions to recover payment therefor without the consent of a Debt Adjustment Board. Such legislation restricts the free operations of business generally, and although debts affected are only those contracted prior to a date named in the Act there is always the fear that this date may be moved forward, as it was in the case of the Debt Adjustment Act of Alberta and the Moratorium Act of Quebec.

In Alberta, we have seen legislative attempts made to cancel part of certain debts altogether, as in the case of

The Reduction and Settlement of Debts Act of 1936, which was held to be *ultra vires* by the courts, but at the most recent session of the Alberta legislature an attempt of this kind was made on a much wider scale. To mention the three most confiscatory measures, there were passed a *Securities Tax Act*, a *Home Owners' Security Act* and an amendment to the *Limitations Act*.

Although the first two of these measures were subsequently disallowed, the effect of them, briefly, was to impose a tax of two per cent. on all mortgages of Alberta lands, regardless of collections received thereon, impose conditions on the foreclosing of home properties, which made it practically impossible for the mortgagee to protect his investment in the event of default, and finally to prohibit actions after 1st July 1940 in respect of nearly all those mortgages, unless the debtor had entered into a new agreement with respect thereto or the Debt Adjustment Board was satisfied that the claim had been sufficiently reduced by the creditor so that the debtor should be willing to sign a new agreement with him.

The Honourable Mr. Ernest Lapointe, Minister of Justice, in reporting to the Dominion cabinet on this and ancillary legislation made this comment: "These enactments are unjust in that they confiscate the property of one group of persons for another group; they authorize and encourage repudiation by debtors regardless of their ability to pay their debts. They discriminate in that they seek to relieve Albertans at the expense of Canadians generally. They impose such a burden on Dominion corporations as will drive them out of Alberta, thus depriving Canadian citizens in Alberta of the services rendered by such corporations. If allowed to operate they will injure public and private credit in Canada."

To most of us the effect of these Acts seems rather remote from our own interests, but when we consider that Canadian life insurance companies have invested nearly nineteen and one-half million dollars in Alberta mortgages and that in Canada there are approximately six and one-half billion dollars of life insurance in force, held by more than three and one-half million Canadians, we realize that these policyholders, together with their families and their dependents, include almost every man, woman and child in the Dominion and every one of them is vitally interested in the

effect of this type of legislation. The premiums entrusted by these policyholders to life companies last year totalled more than two hundred and ten million dollars and represented a substantial portion of the annual savings of the Canadian people, which only serves to accentuate the continuing monetary interest of a large part of our population.

The Dominion Superintendent of Insurance described the probable effect of the recent Alberta legislation in this way:

About 85% of the life insurance in Canada is on the participating plan under which dividends or profits are declared. Up to date these dividends have been at a uniform rate throughout Canada for similar plans and ages, so that policyholders in Alberta have heretofore avoided the loss of dividends which should properly have resulted from the financial policies of the Alberta government. It is obviously impossible for this uniformity of dividends to continue if recent legislation is allowed to operate.

Dividends on life insurance policies throughout Canada are at present depressed by reason of losses occasioned by previous legislation and financial policies in the Province so that policyholders throughout Canada are suffering by reason thereof and will continue to suffer to a greater extent than ever if the legislation remains in force.

All companies with investments in Alberta have already suffered severely from the financial policies of the Alberta government or legislature. Bonds in Alberta held by insurance companies alone to the amount of over twenty million dollars have shown depreciation of nearly one-half of the amount. Collection on mortgages has been interfered with, and procedure for recovery practically prohibited.

As a result of these actions, it has been necessary for the Department to revise the statements of many companies by reducing the values of the assets or increasing reserves held against the same so as to greatly reduce the margin of security shown by the statements, and to lessen the ability of the companies to withstand hazards other than the human hazard.

Residents of Alberta especially should be alive to the possible eventuality which the Superintendent suggests may result from a continuation of legislation of the kind described. There is over \$300,000,000 of insurance in force on the lives of Alberta citizens, held by approximately 150,000 policyholders. It has been estimated that this insurance, if distributed evenly, would give \$400 of insurance to every resident of Alberta and close to \$2,000 to every family. Last year life insurance companies paid out to Albertans 83.5 per cent. of the total revenues collected there, in addition to providing future protection for their

dependents. The stake of Albertans in the security of life insurance companies is a substantial one.

It should be the duty of governments to protect the investments in which they have by statute authorized life insurance companies to invest and not to impair the security of the contracts made by making it more difficult to recover moneys loaned. No one will deny that a debtor, who cannot pay his debts by reason of circumstances beyond his control, is entitled to sympathetic consideration and adequate relief, and life insurance companies have accorded this in thousands of cases. The legislative approach to the problem in Canada, however, has been very unfair, imposing as it does a heavier burden on one class for the benefit of another. In the United States a wise provision of their constitution prevented the confiscation of individual property rights, so that benefits bestowed upon debtors have been at the expense of taxpayers as a whole, which is manifestly a more equitable method.

Restrictive and confiscatory legislation has made considerable headway in Canada with little general opposition presented to it. The time has come to call a halt before the encouragement given to debtors to break their obligations results in the downfall of our whole credit system. The great body of Canadians represented by life insurance policyholders should be awake to the necessity of protecting their savings and defending them against onslaughts which may undermine the greatest co-operative structure known to man, which is embodied in the institution of life insurance.

G. R. G. BAKER.

INCOME WAR TAX ACT DECISION

The William Harold Malkin Case

What was described by Counsel for the Crown as an ingenious attempt to avoid taxation proved to be successful in the judgment of Mr. Justice Maclean delivered in the Exchequer Court of Canada on July 27th. The judgment was rendered in an appeal by Mr. Malkin, a resident of Vancouver, against the decision of the Minister validating an assessment for income tax in the sum of \$2,272.54.

The Settlement

W. H. Malkin was a shareholder in The W. H. Malkin Company, Limited, carrying on business as wholesale grocers in Vancouver. His wife owned a property known as "Southlands" which she had presumably acquired with her own money. Upon her death the property devolved as to one-third to W. H. Malkin and as to two-thirds to the four children, issue of the marriage. W. H. Malkin on 4th November 1934 entered into an agreement with the four children and The Toronto General Trusts Corporation as trustee. The agreement provided for the transfer to the trustee of certain assets. The property "Southlands" was transferred by Malkin and the children upon trust to provide for its upkeep and to sell when a reasonable price could be obtained. The children directed the trustee by letter to allow their father the use of the property till it was sold. He lived therein without paying rent during the taxation period in question. The agreement also provided for the transfer (later carried out) to the trustee of 1600 second preference shares in The W. H. Malkin Company, Limited, upon condition that the trustee enter into a pooling agreement with other shareholders and that it give an irrevocable proxy to Malkin to vote the shares. Transfer of life insurance was also made to the trustee and the settlor was obligated to take out further insurance and to transfer the same, the trustee to pay the premium out of the revenues of the trust and the trustee was also provided with moneys to place still further insurance (fully paid by single premium) on the settlor's life, the moneys being obtained by loans on other policies.

Further Details

The agreement provided for the distribution of the estate amongst the four children of the settlor after his

death. The trustee was required to keep up "Southlands" and to pay insurance premiums, borrowing money if necessary to do so. If the income exceeded the outlay the trustee was to create reserves for meeting future obligations and to pay the balance in equal shares to the four children. The settlor reserved the right to call on the trustee to transfer the trust estate, or any part, to the four children in equal shares. There was also given power of sale over the shares with the settlor's approval subject to pooling agreements, power to enter into pooling agreements with the settlor's approval and in which he might join as a holder of other shares not transferred, and power to invest as the settlor might prescribe such moneys as were on hand from time to time and in trustee investments if he did not designate investments.

Contention of the Crown

The only income of the trust during the taxation period was from dividends on the shares amounting to \$6,400 and all of it was assessed against the settlor as his income. The trustee disbursed over \$8,000 on premiums, taxes and upkeep. On behalf of the Minister it was contended that the trustee was obliged to pay what were essentially the personal and living expenses of the appellant. It was said further that there was no effective alienation of the second preference shares, the appellant having retained irrevocable voting power and having kept them subject to a pooling agreement to which he and his brothers were parties. Furthermore they could not be sold without his consent. Attention was also drawn to the control of the settlor over investments and the settlor's right to call for a conveyance of the whole or part of the trust estate to his children as well as his right to appoint a new trustee by deed or will.

Contention of the Appellant

On behalf of the appellant, the settlor, it was argued that the trust was absolutely irrevocable, that the settlor could never recover any of his property and that there was no provision for his receiving any income therefrom. He occupied "Southlands" only as a result of the revocable permission of his children and the upkeep, it was said, was not a personal and living expense of his. The voting control over the shares only gave him the right to act for the benefit of the whole Malkin family including his children.

Any power or control given to him was not ownership and did not divert the income from one person to another nor did it alter the position of the property. The power to change the trustee did not make the property his property and the right to designate investments was not, in substance, control of the trust estate and was not such control as would give him ownership or possession of the trust estate. Finally, it was said that the income received in respect of the Malkin shares was not received for the benefit of the appellant but for his four children.

Judgment

Mr. Justice Maclean reviewed sections 3(e) and 11 of the Act. He pointed out that it was not necessary for him to determine whether any one, other than the settlor, was liable to taxation on the income of the trust. He thought the occupancy of "Southlands" by the appellant might be dismissed from consideration. Section 3(e) contemplated a situation where the taxpayer, for services rendered, received as salary or remuneration money and something in addition by way either of a living allowance, the full use of premises for living purposes or some other allowance or perquisite, all of which might be considered as part of the gain, salary or remuneration of the taxpayer. The use of "Southlands" was purely permissive and it could be sold over his head at any time without any right to him to call for another residence or a sum of money in lieu of "Southlands." The learned judge distinguished English cases on the basis that the English Act imposed a tax on occupancy of lands as well as on ownership. He stated that he was not overlooking subsection 5 of section 11 enacted in 1934, but there was no question of a tenancy for life in "Southlands" and in any event the Minister had not put himself in a position to avail himself of the provision. American authority was dismissed on the same basis as the English cases, namely, different provisions in the relevant statute.

Avoidance of Duty

His Lordship quoted from several House of Lords decisions and from the Supreme Court of the United States in dismissing the Crown's claim that the whole scheme was devised to avoid taxation. He quoted from Lord Sumner's judgment in *Commissioners v. Fisher's Executors*, 1926 A.C. p. 395 at page 412 as follows: "Every man is entitled if

he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

Mr. Justice Maclean, after quoting extracts to similar effect from other judgments, concluded in his own words as follows:

"In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute. The language of the Income War Tax Act is so exact, expressed with such particularity, that it negatives the suggestion of any intent on the part of the legislature to go outside the field described."

By way of conclusion, the learned judge expressed his view that the only other question was whether the appellant was a beneficiary under the first part of section 11. A "beneficiary," he held, was one for whose benefit property is held by trustees or executors. The beneficiaries, however, of this trust were the children. The appeal was accordingly allowed with costs.

NEW LEGISLATION RESPECTING TAXATION DOMINION AND PROVINCIAL

Editor's Note: The information published under this heading indicates only in general terms the nature of recent legislation of the Provincial Governments respecting Taxation. *For the Text of the legislation, readers should refer to the respective Acts.* As the Dominion Income Tax Act, for the sake of convenience, has been having frequent office consolidations, it has been decided to publish in this column, for reference purposes, the amendments in full each year. A copy of a Dominion Statute can be obtained from the King's Printer, Ottawa, and of a Provincial Statute from the King's Printer of the Province concerned.

To provide information to chartered accountants who are called upon by their clients to prepare taxation returns in other provinces, the Dominion Association of Chartered Accountants some time ago sent to the reference library of each provincial Institute a complete set of tax legislation passed by the various provincial legislatures, and is keeping this information up to date by sending copies of amendments to such legislation as soon as these amendments are available for distribution.

(Continued from August issue)

II. Alberta

The Corporations Taxation Act—The 1938 amendments revised the rates of taxation as follows:

Special companies—The rates and/or basis of taxation applicable to loan companies and trust companies have been revised. For full particulars of the revised basis and rates of taxation reference should be made to the Amending Act.

The Income Tax Act—The principal amendments in 1938 were as follows:

(a) Provisions relating to allowances for depreciation and depletion have been clarified.

(b) Interest on moneys borrowed from without the province is not allowed as a deduction from income unless a separate return is made covering the aggregate amount of such interest and income tax is paid on that amount at the rates applicable to corporations and joint stock companies except that the maximum rate shall not exceed 5%; this provision does not apply to companies liable to taxation under Sections 4 to 17 of *The Corporations Taxation Act* (referred to in this summary as special companies).

(c) Interest payable on unpaid instalments has been reduced from 6% to 5% and interest on overdue instalments has been reduced from 4% to 3%.

(d) The tax rate of 5% applicable to corporations and joint stock companies has been changed: the new rates which apply to all income for the year 1937 are as follows:

First \$2,000.00	—	3%
next 1,000.00	—	4%
next 1,000.00	—	5%
next 1,000.00	—	6%
next 1,000.00	—	7%
next 1,000.00	—	9%

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next 1,000.00	—	10%
next 1,000.00	—	11%
next 1,000.00	—	12%
Balance of income	—	7%

The Corporations Temporary Additional Taxation Act—This Act as amended in 1937 provided for an increase of 10% in the taxes payable under *The Corporations Taxation Act* for the years 1932 to 1937 inclusive. The 1938 amendment provides for the continuance of this additional tax in the year 1939.

III. British Columbia

There have been no amendments to the provincial tax acts in 1938 to date (1st September).

IV. Manitoba

The Corporations Taxation Act—The 1938 amendment, in addition to the taxes already provided for, imposes on banks a surtax of 40% of such taxes: the new provision applies to the taxes becoming due and payable on 1st April 1939 in respect of the year 1938 and taxes becoming due and payable thereafter.

The Income Taxation Act—The numerous amendments in 1938 were directed for the most part to greater uniformity in Dominion and Manitoba income tax practice. The principal amendments are as follows:

(a) The dividends paid to an incorporated company by a company incorporated in Canada, the profits of which have been taxed under *The Income Taxation Act* or under *The Corporations Taxation Act* are wholly exempt. Formerly in many cases a part only of such dividends was exempt.

(b) The aggregate amount allowed for depreciation from and after the fiscal period ending in 1936 shall not exceed the net depreciated cost of the assets as established for Dominion income tax purposes at the end of that period.

(c) Allowances are now made in respect of donations to charitable organizations in Canada. The allowances were formerly restricted to donations to Manitoba organizations.

(d) The deduction for Dominion income tax is now calculated on the income for the current year: heretofore the deduction was based on the Dominion income tax paid in the year in respect of the income of the previous year.

(e) Dividends received by taxpayers other than corporations from companies with head office in Manitoba (the profits of which have been taxed under this act in the fiscal periods ending in 1938 and subsequent periods) are exempt. By special provision contained in schedule 1A the reduction in tax effected by such exemption is measured by the lower rate brackets and not the higher rates to which the income would otherwise be subject.

(f) The credit for taxes paid to other provinces is now based on the taxes payable for the current year. The credit shall not at any time exceed the amount of tax which would otherwise be payable in respect of income derived from sources within such other province nor have the effect of reducing the amount of tax which would otherwise be payable in respect of income derived from sources within the province. The credit is allowed only to individuals and to corporations carrying on business in Manitoba and having head office in Manitoba and in the case of such corporations the credit allowed as a

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deduction from the total tax otherwise payable to Manitoba is the amount which the taxpayer has paid as income tax to such other province or an amount equal to 5% of the income derived from sources within such other province whichever is the greater, subject however to the other limitations already referred to. In the case of individuals the credit only applies if the other province allows a similar credit to persons in receipt of income derived from sources within Manitoba; in the case of corporations the credit is allowed whether or not such reciprocity exists between Manitoba and the other province.

(g) The following rates of taxation are applicable to corporations and joint stock companies:

Fiscal years ending in 1937

Single returns 5%

Consolidated returns 7%

Fiscal years ending in 1938 and thereafter

Single returns: 1% on first \$1,000; 2% on second \$1,000; and so on up to 19% on the nineteenth \$1,000; when the income exceeds \$19,000 the rate is 10% on the whole of the net income.

Consolidated returns: the rates applicable to single returns increased in each case by 2%.

(h) In the case of mining companies operating metalliferous mines the following special rates apply:

5% on first \$100,000; 6% on next \$300,000; 7% on next \$300,000; 8% on next \$300,000; 9% on next \$300,000; 10% on income in excess of \$1,300,000.

Consolidated returns: the aforementioned rates increased in each case by 2%.

(i) The tax on wages, salaries and other income which was imposed by the Special Income Taxation Act is now imposed by part 2 of *The Income Taxation Act* effective 1st May 1937. The rate of taxation has been reduced from 2% to 1%. A number of other amendments have been made in connection with this tax.

The Income Taxation Act and *The Special Income Taxation Act*—These Acts have been repealed and *The Income Taxation Act* has been declared to be a revision and consolidation of these Acts.

V. New Brunswick

The Corporations Tax Act—The 1938 Act replaces the Corporations Tax Act, Chapter 16, 1927 as subsequently amended, which has been repealed.

This Act provides for the payment of annual taxes by (a) banks, insurance companies, trust companies, loan companies, finance companies, telegraph and cable companies, telephone companies, street railway companies, gas and electric companies, express companies, sleeping or parlour car companies and construction companies, hereinafter referred to as special companies; (b) companies operating chain stores; and (c) other companies.

The taxes are payable only by such companies as transact business in the province under their own names or through an agent or otherwise, or, not having a designated office or place of business in the province, hold assets in the province. The taking of orders, the purchase or sale of merchandise or other effects by means of travellers or by mail does not constitute transacting or carrying on business in the province if the company has no agent, representative, vendor, sales-

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man on commission or employee resident in the province or has no place of business in the province. Following is the basis of taxation:

(a) Special Companies—The tax is based on the amount of business done as measured in a variety of ways. For particulars of the rates and bases of the taxes reference should be made to the Act. Trust companies, loan companies and finance companies and insurance agencies accepting insurance in unlicensed companies are also subject to the taxes on capital and profits respectively, referred to below under "other companies." Extra-provincial companies which hold assets in the province but have no office or place of business therein are also liable to pay an annual tax of \$50.00 in addition to all other taxes payable.

(b) Companies Operating Chain Stores—A company which is engaged in the business of operating or maintaining in the province under one general management, supervision or ownership for the purpose of gain two or more shops, stores or other establishments for the offering for sale or sale at retail of any goods, wares or merchandise of any nature or description or whose goods, wares or merchandise of any nature or description are offered for sale or sold at retail at two or more shops, stores or other establishments by an agent or agents on commission or otherwise for such company shall be deemed to be operating or maintaining branch or chain stores and shall pay for each shop, store or other establishment so operated or maintained an annual tax, the amount of which shall be fixed by the Governor in Council, in addition to any other taxes imposed by the Act. Provision is made for a rebate in cases where the annual tax exceeds a percentage to be fixed by the Governor in Council of the gross turnover for the preceding calendar year.

Chain store companies are also subject to the taxes on capital and profits respectively, referred to below under "other companies." Extra-provincial companies which hold assets in the province but have no office or place of business therein are also liable to pay an annual tax of \$50.00 in addition to all other taxes payable.

(c) Other Companies—

Capital tax— $\frac{1}{2}\%$ of paid-up capital (as defined) subject to minimum taxes as follows:

Capital—\$10,000.00 to \$25,000.00	—	\$ 25.00
Capital—Over \$25,000.00	—	50.00
Extra-provincial companies	—	100.00

Profits tax—1%

Additional (sic.) tax of \$50.00: payable by extra-provincial companies which hold assets in the province but have no office or place of business therein.

All returns of income are required and the profits tax is payable within four months of the close of the fiscal year. All other taxes are payable on 1st June in each year and are considered to be the tax for the year following that date.

VI. Nova Scotia

There were no amendments in 1938 to date (1st September) to *The Domestic, Dominion and Foreign Corporations Act* or to *The Provincial Revenue (Corporations) Act*.

VII. Ontario

The only amendments in 1938 to date (1st September) to the four taxation acts referred to in our summary in the August 1937

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issue of THE CANADIAN CHARTERED ACCOUNTANT were in the nature of corrections of technical errors.

VIII. Prince Edward Island

Companies Tax Act—There have been no amendments in 1938 to date (1st September).

The Income and Personal Property Taxation Act—This Act has been repealed. Forms of taxation formerly covered by this Act are now covered by *The Personal Property and Special Companies Taxation Act* and *The Income Tax Act of Prince Edward Island, 1938*.

The Personal Property and Special Companies Taxation Act—This Act is, in effect, a rearrangement of the clauses of *The Income and Personal Property Taxation Act* other than those clauses dealing with the taxation of income.

The taxes on personal property and the taxes imposed on banks, trust companies, insurance companies and other special classes of companies are retained without change.

There is a provision in the Act the effect of which is that any person who is assessed and taxed on the personal property from which his income is derived pays only an aggregate amount equivalent to the tax on personal property or the tax on income whichever is the greater.

The returns and payment of the tax are as follows:

Individuals and companies:

Returns to be made when required.

Employees:

Returns not now required under this Act.

Special companies:

Returns required 1st April (1st May in 1938) tax based on such return is paid semi-annually on 1st June and 1st December.

No returns are required where the tax payable is a sum certain.

The Income Tax Act of Prince Edward Island, 1938—This Act which follows very closely the form of the *Dominion Income War Tax Act* provides for a tax on the income during the preceding year of every person which includes any body corporate and politic and in addition, trust, personal corporations or other body and the heirs, executors, administrators and curators or other legal representatives of such persons according to the law of Prince Edward Island (a) residing or ordinarily resident in Prince Edward Island during such year, or (b) who sojourns in Prince Edward Island for a period or periods amounting to 183 days during such year, or (c) who is employed in Prince Edward Island during such year, or (d) who not being resident in Prince Edward Island is carrying on business in Prince Edward Island during such year, or (e) who not being resident in Prince Edward Island derives income for services rendered in Prince Edward Island during such year otherwise than in the course of regular or continuous employment or any person resident or carrying on business or corporation carrying on business in Prince Edward Island, or (f) who before his appointment was a resident of Prince Edward Island and is now or was during such year or any part thereof or hereafter becomes a Minister, High Commissioner, officer, servant or employee of the government of Canada or an agent general for any of the provinces of Canada or any officer, servant or employee thereof resident outside of Canada except upon income arising from his official position.

THE CANADIAN CHARTERED ACCOUNTANT

The basis of taxation is as follows:

(a) **Individuals**—The exemptions allowed according to the marital status or number and class of dependents of the taxpayer are one half those provided for in the *Dominion Income War Tax Act* excepting that special exemptions are given to war veterans. The tax is calculated at progressive percentages commencing with 1% on the first \$500, 1½% on the next \$500, and so on up to a maximum rate of 10% on net taxable income in excess of \$20,000.00. There is no surtax (that is, on "investment income") nor additional tax.

(b) **Partnerships** as such are not liable to taxation but the shares of the partners in the income of the partnership whether distributed or not are taxable in the hands of the partners.

(c) **Personal Corporations**—There are no references to this type of corporation in the Act.

(d) **Corporations**—The income of any company which is a domiciled company within the meaning of the *Companies Tax Act, 1931* and amendments thereto is exempt under this Act; also the income of electric light and power companies, fire insurance companies, life insurance companies, accident and guarantee insurance companies, trust companies, loan and building institutions and companies, telegraph companies, telephone companies, banks or banking companies, chain store or chain wholesale store companies, chain theatre companies, steamship companies, railway express companies, automobile acceptance or finance companies, stock brokers or investment brokers (except as to income arising from sources other than the brokerage business) being taxed under *The Personal Property and Special Companies Taxation Act, 1938*, are exempt from taxation under this act.

Taxable income has substantially the same meaning as under the *Dominion Income War Tax Act*. The following points should be observed, however:

The Dominion income tax payable on the income for the year is allowed as a deduction for the purpose of determining taxable income in Prince Edward Island. In the case of non-residents only that portion of the Dominion income tax arising from income derived from sources in Prince Edward Island is deductible.

Non-residents carrying on business in Prince Edward Island or who derive income from services rendered in Prince Edward Island otherwise than in the course of regular or continuous employment or any person or corporation carrying on business in Prince Edward Island are taxable only in respect of the profits arising from such business or the income so earned.

The tax paid to Great Britain or any of its self-governing colonies or dependencies or to any province in the Dominion of Canada for income tax in respect of the income of the taxpayer derived from sources therein may be deducted from the tax otherwise payable. This deduction does not extend to the tax paid under the *Dominion Income War Tax Act*. A similar deduction is made in respect of income tax paid to any foreign country if such country grants similar credit to persons in receipt of income derived from sources within Canada. The deductions in all cases are limited to the amount of tax otherwise payable in respect of the income which has been subject to taxation elsewhere.

The returns and payment of tax are as follows:—Under an arrangement with the Dominion government the return of income required under the *Dominion Income War Tax Act* serves also as a return of income under this Act. A special form of return (Form T2 Dom.-

NEW LEGISLATION RESPECTING TAXATION

P.E.I.) has been provided by the Dominion government for persons subject to taxation under this Act. The Prince Edward Island tax is paid as to 1/3 with the return, and as to the balance within four months thereafter together with interest at 5% per annum. Additional interest at the rate of 3% per annum on arrears of taxes is provided for.

IX. Quebec

Corporation Tax Act—By amendments of 1938, the application of the provision imposing a tax on revenue has been extended a further two years: the revenue for the fiscal years current on the 19th February 1938 and 1939 are now subject to such tax.

X. Saskatchewan

The Corporations Taxation Act—The 1938 amendments provide that section 18 of the Act will not now apply to a company carrying on operations within the Province for the development of natural gas or oil wells or metal mines until the company commences actual production. Such companies are required to pay an annual tax of \$25.00 on the first day of January in each year until such time as they become liable to taxation under section 18.

The taxes payable by insurance companies have been increased by one-half for all payments to be made during the year beginning on first May 1938 and ending on thirtieth April 1939.

The Income Tax Act, 1936—The few amendments in 1938 (contained in the *Statute Law Amendment Act, 1938*) do not affect the basis or rates of taxation.

GENERAL NOTES

Our Contributors This Month

KRIS AUSTIN MAPP, F.C.A., is a partner of the firm of Henry Barber, Mapp and Mapp, Chartered Accountants, of Toronto. He is a former President of the Institute of Chartered Accountants of Ontario and was for some years Chairman of the Institute's Committee on Education. At the last annual meeting of the Canadian Society of Cost Accountants and Industrial Engineers he was elected President for the year 1938-39.

EDWARD CHARLES SHAUGHNESSY who discusses the subject of sales taxes this month was born and educated in Toronto. He served his articles with Messrs. Wilton C. Eddis & Sons, Toronto, and George A. Touche & Company, Edmonton, and passed the final examinations of the Institute of Chartered Accountants of Alberta in 1932. Since then, with the exception of two years in private practice, he has been employed by the Alberta government first as Provincial auditor and latterly in its Income Tax Branch.

The other contributors this month are already familiar to our readers.

Bidding for Audits

The members of our profession will be interested to read the following comments which appeared in the Brockville (Ontario) *Recorder-Times* on 29th July last: "A common mistake made by municipal councils is the awarding of audit contracts on the basis of bids. The value of any audit is in direct proportion to the ability, experience, and skill of the accountant. An audit does not consist merely of the checking of figures; in fact, that is the least valuable part of an audit. The most important part is the interpretation of the results in the light of the law and principles of sound management and administration. Every accountant cannot give the same value in this respect, hence audits awarded to the lowest bidder are usually worth what they cost, or perhaps less. A butcher can remove an appendix much more cheaply than a surgeon, but his services would hardly be engaged on that basis. Until councils realize that the important thing in selecting an accountant is not price,

but skill, experience, and judgment, the citizens will not receive the protection to which they are entitled."

Home Improvement Loans

The Department of Finance announced on 11th August that of the total Home Improvement Loans reported by the lending institutions to 30th June, 1938, the number made in cities and towns of Canada with population of 5,000 and upward was 32,164, and their total amount \$13,214,005.

Following is a list of cities with a population of 40,000 or over, with the number and amount of the loans:

Halifax	518	\$ 191,916
Saint John	535	220,452
Quebec	292	170,431
Montreal	2,233	1,148,896
Verdun	148	56,175
Hamilton	995	279,524
London	746	254,628
Ottawa	765	363,856
Toronto	4,826	1,783,248
Windsor	736	272,955
Winnipeg	1,596	613,420
Regina	215	75,203
Saskatoon	139	45,273
Calgary	671	277,885
Edmonton	923	519,273
Vancouver	2,049	584,999
Victoria	389	126,600

State Aid to Industry in Great Britain

A fundamental feature of economic policy in recent years has been the growing measure of State assistance accorded to British industries, states *The Economist* (London). The Chancellor of the Exchequer recently gave the House of Commons particulars of subsidies from public funds payable to industry since 1st October 1931, up to and including estimated expenditure during the current year. The total was £55,062,060, and the details were as follows:—

THE CANADIAN CHARTERED ACCOUNTANT

	<i>(Thousands of £)</i>
Beet sugar	21,164
Cattle: payments to producers	18,218
Milk	5,764
Land fertility improvement	1,889
Oats and barley	203
Tramp shipping	4,002
Herring industry	130
Light horse breeding	49
Mechanical transport	13
Civil aviation	3,627

Direct subsidies form only a fraction of a total which to be complete should also include, not only direct aid in such forms as revenue rebates and rating reliefs, but also the value of tariffs, preferences, quotas, special assessments for income tax and the grant of statutory monopoly powers to the beneficiary industries. Sir John Simon's total of £55 millions for some seven years represents only a small portion of the total benefits derived.

PROVINCIAL NEWS

SASKATCHEWAN

On June 27th the Regina members of the Institute were honoured with a visit from Mr. Frank A. Nightingale, Halifax, President of the Dominion Association, and Mr. W. E. Hodge, Moose Jaw, Vice-President.

At noon Mr. Nightingale was entertained to a luncheon at the Assiniboia Club by the members of Council and the Past Presidents of the Association resident in Regina, and this was followed by an informal round-table conference.

In the evening a luncheon was held in their honour by the Chartered Accountants' Club of Regina, and Mr. Nightingale delivered an address on matters affecting the profession in general, and having particular reference to educational matters, income tax, the magazine, and legislation. A discussion took place afterwards and altogether a very pleasant and profitable evening was spent.

LEGAL DECISIONS

[**EDITOR'S NOTE:** The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Income tax — Dividends to non-residents — Distribution of surplus

(*The King v. Johnson Matthey & Co.*)

Exchequer Court of Canada

A dividend to non-resident shareholders in the form of an issue of shares of a company's capital stock of an aggregate par value equal to its surplus is a "stock dividend" and taxable under s. 9B of the *Income War Tax Act* regardless of the fact that no "payment" and no "currency" was actually involved in the transaction.—[1938] 3 D.L.R. 15.

(A summary of this judgment appeared in the May 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT.)

Succession duties—Gifts through corporation—Profits on shares

(*re Meilicke et al*)

Saskatchewan Court of Appeal

The transfer *inter vivos* of company shares to a corporation formed to acquire it, in consideration of shares issued by it which are distributed amongst the children of the transferor, the transaction being made in good faith and for valuable consideration, held not a mere sham to use the corporation as an agency to effect a gift to the children and that the shares so transferred and the profit increment to them are not taxable under the *Succession Duty Act*, R.S.S. 1930, c. 37, as amended in 1937, as gifts by the deceased to his children; the shares are the property of the holding company and the profits accruing on them form an accretion to its capital or are distributable as a dividend if so permitted by the articles of incorporation. The penalties under the statute are recoverable by summary application to any Court of competent jurisdiction, as provided by s. 57, without any information by the attorney-general. Non-

resident beneficiaries are subject to the requirements of filing returns or to the penalties for failing to do so. The remission of part of the purchase-price of land sold to a child is taxable as a gift *inter vivos*; it is not a mere adjustment of debt.—[1938] 3 D.L.R. 33.

Taxation—Direct taxation within province—Income outside of province

(*Re Kerr*)

Alberta Supreme Court

Provincial power as to "Direct Taxation within the Province" under s. 92 of the B.N.A. Act does not extend to income earned outside of the Province, not received or remaining in the Province where the tax is sought to be imposed.

Dividend cheques received in Alberta from an American corporation situated in the United States, which were neither cashed in Alberta nor deposited in any banks there, are not taxable as income under the Alberta Income Tax Act; similarly, when such cheques are received in Alberta but endorsed over and forwarded for deposit in banks outside of that Province. But when received in Alberta and either cashed or deposited in banks there they are taxable as income within the Province.—[1938] 3 D.L.R. 23.

Wills—Right to delay conversion beyond normal period of distribution

(*Re Gage*)

Supreme Court of Canada

Words in a will empowering trustees to delay conversion if advisable for a period not exceeding 3 years beyond the period of distribution which would normally take place at the expiration of 15 years, held to extend not merely the realization period but also the absolute vesting and distribution.—[1938] 2 D.L.R. 737.

OBITUARY

The Late Frank Micklewright Harvey

The Dominion Association of Chartered Accountants and the Institute of Chartered Accountants of Alberta announce with deep regret the death at Calgary on 3rd August of Frank Micklewright Harvey, F.C.A., a former President of the Association and of the Institute. With his passing the profession in Canada has lost a member who was possessed of sound judgment, exceptional ability and great personal charm—one whose influence and example will long live in the minds of those who had the privilege of knowing him. At the funeral services held on 6th August, The Dominion Association was represented by D. A. McCannel, a former President, and the Alberta Institute by C. P. Ponton, the President of the Institute.

The late Mr. Harvey had a distinguished career, and for particulars in regard thereto opportunity is taken of publishing below the resolution passed at a special meeting of the Council of the Institute of Chartered Accountants of Alberta held 6th August 1938:

"That the members of this Council desire to place upon the records the following tribute to the memory of their departed colleague and that the page in this book following the minutes of this meeting be forever left blank as a token of his unsullied reputation:—

"With the death of Mr. Harvey, who was born in Liverpool, England, on 24th January 1871, the profession in this Province and in this Dominion has lost an outstanding figure. In his earlier years he started on a banking career but in 1898 he entered the work of the profession to which he devoted the remainder of his life. He served for eleven years on this Council, was President of this Institute and was for many years one of the ablest members of the Accountancy Board of Examiners of the University of Alberta. In recognition of the conspicuous service which he had rendered to the profession

[Continued on overleaf]

he was elected a Fellow of the Institute in 1931. A year later he received the highest honour in the profession in Canada by being elected President of The Dominion Association of Chartered Accountants. Much of his professional work was for the public benefit in making investigations for cities and governments and he will long be remembered for the service he voluntarily rendered to many civic organizations, especially the Calgary Symphony Orchestra, in the advancement of good music, of which he was so passionately fond. He was possessed of sound judgment, broad outlook and exceptional ability, and being a gentleman of great personal charm he was regarded with affection as well as esteem. His fellow members and friends and the community generally are the poorer by his passing, but they are the richer for the privilege of having had his example and influence for so many years."

Further reference to our late respected member is made in the Editorial section of this month's issue.

Mr. Harvey is survived by his wife and one daughter, Mrs. C. J. Weekes of Vancouver, to whom the members of the profession throughout Canada extend their sincere sympathy.

TERMINOLOGY DEPARTMENT

The articles in this Department, unless otherwise stated, are originally written by the Chairman of the Terminology Committee and submitted to the members thereof; they are afterwards revised by him after consideration of suggestions made by the members.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to Students-in-Accounts; and it is believed that, to impart a thorough understanding, too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

(Continued from August issue)

Income: (1) The annual earnings and other receipts of an individual or a company, whether derived from services rendered, investments, manufacturing, or trading. "Gross Income" is that shown before deduction of the expenses necessitated by the nature of the business; the remainder after such deduction is "net income."

(2) The total subscriptions and other receipts of a non-profit earning organization, such as a club, society, hospital, etc.

Income and Expenditure Account: A term used by non-profit earning organizations such as clubs, hospitals, societies, etc. for the account and statements which, in trading organizations, would be called "Profit and Loss Account." It includes all income earned and expenditures incurred during the period covered, whether or not the income has all been received or the expenditures all paid, and thus differs from a "Receipts and Disbursements Account," which shows actual cash transactions only.

Income Bonds: Bonds on which the payment of interest is dependent on the earnings of the company.

Increment: An increase in value of property, due not to any effort exerted by the owner but to a rise in price brought about by other means. A representative example is found in an increase in the value of land, held but not improved by the owner, in a growing district, where increased demand for land is caused by the growth of general business or for other reasons. ("Accounting Terminology"—New York 1931).

Indirect Liability: Contingent Liability.

Indorsement: Endorsement; writing on the back of a document (Latin *dorsare*, back), more particularly assign-

ing by writing one's name on the back of a bill or cheque. The act is not only necessary for the negotiation of a bill or cheque, but also carries certain liabilities to a subsequent holder for value.

Insolvency: Being unable to pay debts as they become due; the condition when liabilities exceed the realizable value of assets.

Instalment: A partial payment. An instalment contract is one which provides that payments be paid in instalments on specified dates.

Intangible: "Tangible" means that which can be touched, thus something which has corporeal existence. Therefore an "intangible" asset is one which has no physical existence, and yet may have value which lies in rights or privileges conferred on its owner, e.g., patents, copyrights, trade marks, goodwill, etc. "Intangible value" is the value of a business as a going concern over and above the depreciated cost of its net tangible assets.

Interim: Intervening; meanwhile; provisional; temporary. An interim account is one made up other than for the usual financial period; an interim dividend is one paid during a financial period rather than at the end of such period when profits are finally determined.

Internal audit: An audit of detail matters carried out by an employee of a business, as distinct from that done by an independent outside auditor.

Internal check: The result of the organization of a business so that no transaction can take place on the initiative or through the hands of any one person alone, and thus that two or more persons are cognizant of each transaction. By this arrangement one employee or group of employees are constantly checking the work of other employees or groups.

Inventory: Strictly, a list—of anything. Thus, a list of accounts receivable is just as much an inventory as one of goods on hand. In the accounts of executors, trustees, administrators, the word is used to cover the list of all properties, tangible and intangible, stock-in-trade, accounts receivable, investments, cash on hand and bank accounts, etc. Such an inventory is attached to the affidavit for probate. It is also used for the detailed list of property

which accompanies a bill of sale or a lease of furnished premises.

In mercantile accounting, however, the meaning of the word is being narrowed down to (1) the list of goods comprising the Stock-in-Trade and (2) the Stock-in-Trade itself. Thus on balance sheets it is not unusual to find an asset described by the one word "Inventory." Moreover, the Companies Act (Canada) appears to give some authority for using the word in this manner.

Nevertheless, it is submitted that it would be better to make the description "Inventory of Stock-in-Trade," so as to make the item more clear, and, since the value attached is that of the Stock-in-Trade itself and not the list or inventory, better still to use the words "Stock-in-Trade per Inventory."

Inventory Certificate: A certificate obtained by an auditor from a responsible officer in an enterprise as to the correctness of the inventories of stock-in-trade. It usually covers the methods of determining the quantities and valuations, matters relating to ownership, declarations as to salability (or conversely obsolescence), etc., and should usually be both signed and witnessed.

Investigation: As an accounting term, a special audit conducted for a particular purpose. Depending on such purpose, it may or may not be more extensive and deeper in character than the regular shareholders' or proprietors' annual audit. Examples are:—investigation of profits over a term of years for a prospective purchaser or in connection with a new issue of stocks or bonds; scrutiny of books, vouchers, etc. in connection with fraud; investigation on behalf of a bank, finance company or individual who is proposing to finance a business by advancing money, etc.

Investments: The expenditure of moneys in properties or securities for the purpose of income; the properties or securities so acquired.

Invoice: A document showing the particulars of merchandise sold, addressed to the purchaser thereof, with the prices, value and charges annexed.

Invoice Register: See "Purchase Register."

Issued Capital: Subscribed capital (see "Capital"). "Issued Capital" is that which has been allotted, irrespective of whether or not it is fully paid, and the term is not to be confused with Capital for which certificates have been "issued."

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The thoughts of many of our readers will once again be turning to intensive study in preparation for the year-end examinations. We hope that summer activities will build up reserves of health and energy which will maintain all students in the good physical condition which is essential (in most of us) to efficient mental operation, but that none will neglect throughout the period of study any opportunity of exercise and outdoor recreation which is offered to him. It is strange to think that the mark we may get in, say, the final accounting examination will be affected by the condition of our abdominal muscles, but there can be no doubt that a connection exists between these two things. Physical distress indeed appears to have furnished a powerful stimulus to the genius of such men as Voltaire, Napoleon and Sir Walter Scott, but most of us seemingly lack the peculiar type of genius which responds to such strange promptings.

* * *

An English company of world renown recently secured a great deal of publicity by publishing its annual statements without the usual shillings and pence columns and using instead, decimals of a pound. To the public at large this may have been a valuable demonstration of the superiority of a decimal system over the cumbrous English system of £ s. d. Amongst the more tutored readers, however, it was apparently regarded as a provoking piece of camouflage whose effect was to distract attention from the circumstance that the statements of this particular company gave so little information anyhow that figures might just as well be stated correct to the nearest ten thousand pounds. When precision is, in fact, lacking it is just as misleading to state an item at point four nine of a pound as to state it at nine shillings and ten pence.

In this particular case there was a feeling that information was being deliberately withheld. In nine cases out of ten however, accounting statements prepared with the greatest care inevitably lack the precision which they appear to convey. We wonder whether in these circumstances it would not be wise (as some companies in the United

States already do) to omit the cents figures entirely, or even to go further and state all figures in published statements at the nearest one hundred or one thousand dollars.

* * *

PROBLEMS AND SOLUTIONS

Solutions presented in this section of the present issue have been prepared by the Editor of the Department who cordially invites discussion of the solutions.

PROBLEM I.

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

INTERMEDIATE EXAMINATIONS, NOVEMBER 1937

BOOK-KEEPING AND ACCOUNTS. Question 4.

Messrs. Jones & Smith's premises caught fire on October 22nd, 1937, and the stock was damaged.

The firm had made up Accounts to December 31st each year and at December 31st, 1936, the Stock (at cost) was £13,272, as against £9,614 at December 31st, 1935. Purchases from January 1st, 1937, to October 22nd, 1937, were £34,827, against £45,258 for the full year 1936 and the corresponding sales figures were £49,170 and £52,000 respectively.

You are given the following further information:—

- In April, 1937, goods which cost £1,000 were given away for advertising purposes, no entries being made in the books.
- A clerk had misappropriated unrecorded cash sales during 1937. It is estimated that the defalcations averaged £20 per week from January 1st, 1937, until the clerk was discharged on May 20th, 1937.
- The rate of gross profit is constant.

From the foregoing, you are required to make an estimate of the Stock at the date of the fire.

SOLUTION

CALCULATION OF THE CONSTANT RATE OF GROSS PROFIT BY REFERENCE TO THE COMPLETE FIGURES OF 1936.

Sales, January 1 to December 31, 1936	£52,000
Stock, January 1, 1936	£ 9,614
Purchases, Jan. 1 to Dec. 31, 1936	45,258
	<hr/>
	54,872
Stock, December 31, 1936	13,272
	<hr/>
Cost of Sales	41,600
Gross Profit on Sales	<u>£10,400</u>

The percentage of gross profit on sales is therefore
 $10,400 \times 100 = 20$, and the cost of sales is 80 per cent. of the sales.
52,000

THE CANADIAN CHARTERED ACCOUNTANT

ESTIMATE OF THE STOCK AT THE DATE OF THE FIRE, OCTOBER 22, 1937.

Stock, January 1, 1937	£13,272
Purchases, January 1 to October 22, 1937	34,827
	<u>48,099</u>
Less:	
Cost of goods given away for advertising purposes £ 1,000	
Cost of goods sold:	
Recorded sales	£49,170
Unrecorded sales (20 weeks at £20 per week)	400
	<u>£49,570</u>
80 per cent. of £49,570	39,656
	<u>40,656</u>
	<u>£ 7,443</u>

PROBLEM II.

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

FINAL EXAMINATIONS, NOVEMBER 1937

ADVANCED BOOK-KEEPING AND ACCOUNTS. Question 2.

Towns and Field, who shared profits in the proportion of two-thirds and one-third respectively, were in partnership as Estate Agents in London, and Willet, who carried on a similar business in Folkestone, acted as their local agent.

The two concerns amalgamated as from October 1st, 1936, on which date their respective Balance Sheets were as under:—

TOWNS AND FIELD

LIABILITIES & CAPITAL		ASSETS	
	£		£
Creditors:—		Furniture	120
Clients	2,200	Debtors	3,850
Sundry Expenses. 700	2,900	Bank Balance	2,780
		Do. "C" Account. 2,500	
Capital Accounts:—		Cash in Hand	50
Towns	3,800		
Field	2,600		
	<u>£9,300</u>		<u>£9,300</u>

WILLET

LIABILITIES & CAPITAL		ASSETS	
	£		£
Creditors:—		Furniture	100
Clients	1,600	Debtors for Disbursements. 820	
Sundry Expenses. 250	1,850	Bank Balance	1,600
		Do. "C" Account. 1,940	
Capital Account ...	2,650	Cash in Hand	40
	<u>£4,500</u>		<u>£4,500</u>

STUDENTS' DEPARTMENT

In the case of Towns and Field, credit had been taken for commission and fees earned but Willet had kept his accounts on a cash basis.

The terms relating to the amalgamation and the new partnership were:—

- (a) Towns and Field were to manage the London Office and Willet was to be in charge of the Folkestone Office.
- (b) The Goodwill of Towns and Field was valued at £6,000 and that of Willet at £3,600. (No Goodwill Accounts were raised but the necessary adjustments relating thereto, on the basis of the profit sharing ratios, were dealt with in the Capital Accounts. As between Towns and Field no adjustment was required).
- (c) Profits and losses were to be divided as follows:—

	TOWNS	FIELD	WILLET
LONDON	One-half	Three-tenths	One-fifth
FOLKESTONE	Three-tenths	One-fifth	One-half
- (d) Prior to the amalgamation the value of the Furniture, in each case, was reduced by 50%.
- (e) Commission and Fees received at Folkestone after October 1st, 1936, for work done prior to that date were to be credited to Willet.
- (f) Interest on Capital was to be allowed at 5% per annum.
- (g) Provision was made for the following annual salaries—Towns £800: Field £600: Willet £600.
- (h) Commission amounting to £300, due by Towns and Field to Willet on October 1st, 1936, was to be transferred to Willet's Capital Account.

The figures relating to the transactions of the firm for the year to September 30th, 1937, were:—

	LONDON		FOLKESTONE	
	Dr.	Cr.	Dr.	Cr.
Commission and Fees charged		9,477		5,265
Do. 1935/36 (Willet) ..				620
Partners' Drawings:—				
Towns	1,200			
Field	1,000			
Willet			1,300	
Staff Salaries and Office Expenses ...	5,820		3,540	
Debtors	3,710		1,685	
Creditors—Clients		1,830		1,520
Do. —Expenses		450		230
Bank Balances:				
Office Accounts	4,367		1,960	
"C" Accounts	2,190		1,660	
Cash	50		40	

A separate set of books was kept at each Office but the Annual Accounts and Willet's Capital Account appeared in the London books. The interest on the latter was to be charged against the Folkestone business.

From the foregoing information you are required:—

- (a) To make the necessary adjustments consequent upon the amalgamation.
- (b) To prepare, in columnar form, a Profit and Loss Account for the year to September 30th, 1937, and a Balance Sheet as on that date.
- (c) To shew the Partners' Capital Accounts and the Folkestone Office Account in the London books.

SOLUTION

(a) **ADJUSTMENTS NECESSITATED BY THE AMALGAMATION**

(1) On the books of Towns and Field, prior to the amalgamation:

Towns, Capital Account	£ 40	
Field, Capital Account	20	
To Furniture		£ 60

To adjust value of furniture.

(2) On the books of Willet, prior to the amalgamation:

Willet, Capital Account	£ 50	
To Furniture		£ 50
To adjust value of furniture.		
Commission Receivable	300	
To Willet, Capital Account		300
To bring on to the books commission due from Towns and Field.		

(3) On the books of the new partnership, at the time of amalgamation:

LONDON OFFICE BOOKS

Folkestone Office Account	£2,600	
Creditors—Sundry Expenses	300	
To Willet, Capital Account		£2,900
To record assumption of Willet's business by the new partnership.		

FOLKESTONE OFFICE BOOKS

Capital Account	£2,900	
To London Office Account		£2,600
Commission Receivable		300
To adapt Willet's books to the use of the new partnership.		

LONDON OFFICE BOOKS

Towns, Capital Account	£ 80	
Field, Capital Account	520	
To Willet, Capital Account		£ 600
To record adjustments for goodwill as per Schedule I below.		

**SCHEDULE I.
GOODWILL ADJUSTMENTS**

Item	Total	Towns	Field	Willet
Credits:				
Goodwill of London business	£6,000	£4,000	£2,000	—
Goodwill of Folkestone business ...	3,600	—	—	£3,600
Total Credits	£9,600	£4,000	£2,000	£3,600
Debits:				
Goodwill of London business	£6,000	£3,000	£1,800	£1,200
Goodwill of Folkestone business ..	3,600	1,080	720	1,800
Total Debits	£9,600	£4,080	£2,520	£3,000
Net Adjustment		Dr. £80	Dr. £520	Cr. £600

Note: The agreed goodwill of each business is credited to the former owners in the ratio in which those former owners shared the profits of that business; it is debited to the members of the new partnership in the ratio in which they have agreed hereafter to share the profits of that business.

STUDENTS' DEPARTMENT

TOWNS, FIELD AND WILLET

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING SEPTEMBER 30, 1937 AND PROFIT AND LOSS APPROPRIATION ACCOUNT AS AT THAT DATE.

Item	Total	London	Folkestone
Commissions and Fees Charged	£14,742	£9,477	£5,265
Staff Salaries and Office Expenses	9,360	5,820	3,540
Operating Profit	<u>£ 5,382</u>	<u>£3,657</u>	<u>£1,725</u>
Partners' Salaries:			
Towns		£ 800	
Field		600	
Willet			£ 600
Interest on Capital at 5% per annum:			
Towns (on £3,680)		184	
Field (on £2,060)		103	
Willet (on £3,500)			175
		<u>1,687</u>	<u>775</u>
Share of Profit:			
London:			
Towns 1/2		985	
Field 3/10		591	
Willet 1/5		394	
Folkestone:			
Towns 3/10			285
Field 1/5			190
Willet 1/2			475
		<u>£3,657</u>	<u>£1,725</u>

TOWNS, FIELD AND WILLET

BALANCE SHEET, AS AT SEPTEMBER 30, 1937.

ASSETS	Total	London	Folkestone
Cash on Hand	£ 90	£ 50	£ 40
Bank Balances:			
Office Accounts	6,327	4,367	1,960
"C" Accounts	3,850	2,190	1,660
Debtors	5,395	3,710	1,685
Furniture	110	60	50
Folkestone Office Account	—	3,645	—
	<u>£15,772</u>	<u>£14,022</u>	<u>£ 5,395</u>
LIABILITIES AND CAPITAL	Total	London	Folkestone
Creditors—Clients	£ 3,350	£ 1,830	£1,520
Creditors—Expenses	680	450	230
Capital Accounts as per (c) below:			
Fields	4,734	4,734	
Town	2,544	2,544	
Willet	4,464	4,464	
London Office Account	—	—	3,645
	<u>£15,772</u>	<u>£14,022</u>	<u>£ 5,395</u>

THE CANADIAN CHARTERED ACCOUNTANT

(c) PARTNERS' CAPITAL ACCOUNTS

CREDITS		Total	Towns	Field	Willet
Balance as per original balance sheet		£9,050	£3,800	£2,600	£2,650
Commission Receivable from Towns and Field		300			300
Goodwill		600			600
Salaries		2,000	800	600	600
Interest on Capital		462	184	103	175
Share of Profit—London		1,970	985	591	394
—Folkestone		950	285	190	475
Commission and Fees, 1935/36		620			620
		<u>£15,952</u>	<u>£6,054</u>	<u>£4,084</u>	<u>£5,814</u>
DEBITS		Total	Towns	Field	Willet
Furniture		£ 110	£ 40	£ 20	£ 50
Goodwill		600	80	520	
Drawings		3,500	1,200	1,000	1,300
Balance, Sept. 30, 1937		11,742	4,734	2,544	4,464
		<u>£15,952</u>	<u>£6,054</u>	<u>£4,084</u>	<u>£5,814</u>

FOLKESTONE OFFICE ACCOUNT

1936		1937	
Oct. 1	Willet — Capital Account	Sept. 30	Willet — Capital Account, for drawings
	£2,600		£1,300
1937			
Sept. 30	Profit for the Year	1,725	" 30 Balance
" 30	Commissions and Fees 1935/36 credited to Willet's Capital Acct.	620	3,645
		<u>£4,945</u>	
1937			
Oct. 1	Balance	£3,645	<u>£4,945</u>

